

MINISTRY OF FINANCE

FLASH REPORT

ON
KEY FEATURES OF ECONOMIC PROCESSES
AND FINANCIAL FLOWS
(BASED ON DATA FOR JANUARY-JUNE 2003)

Budapest, 5 June 2003

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TABLES

Flash Report on Main characteristics of economic processes and financial flows¹

(based on data for January-June 2003)

Our analyses of the different fields of the national economy have been prepared on the basis of the most recent figures available. For the GDP, only overall figures of quarter 1 are available. Also, the assessment of foreign trade, investments, industrial production including constructions and wages are based on the published Q1 data, while for labour market developments or consumer prices, figures of the January to April period are delivered. For overall budget categories, our analysis is based on the statistics of the January to May period. No figures are yet available concerning households' savings or debts in 2003.

1. International conditions

The global economic slowdown proved to be more profound and persistent than forecasted by international institutions in 2001 and 2002. New uncertainties caused by the international conflicts in connection with the Iraqi crisis deteriorated the outlook for a fast recovery further. Now it seems clear that the end of the war on Iraq would not bring along the start of an economic upturn, either.

Recovery is still not to start yet

Global growth outlook largely hinges upon the economic developments in the U.S. According to OECD and IMF estimates, **world economic growth** is to be expected at around 2.5 and 3.0 per cent in 2003. Also, the European Union adjusted its former forecasts downward to 3.2 per cent.

Economic recovery in the **U.S.** is still fragile and somewhat weaker than expected. With stimulating monetary and fiscal measures, a modest increase of growth indicators is estimated. In particular, OECD forecasts have indicated a GDP growth of 2.5 per cent both in 2003 and 2004. Despite the depreciation of the U.S. dollar, weakening consumer confidence indices and the decline in households' spending, investments stabilised justifying a cautious optimism.

The U.S. economy has started to recover, although slowly and with uncertainties

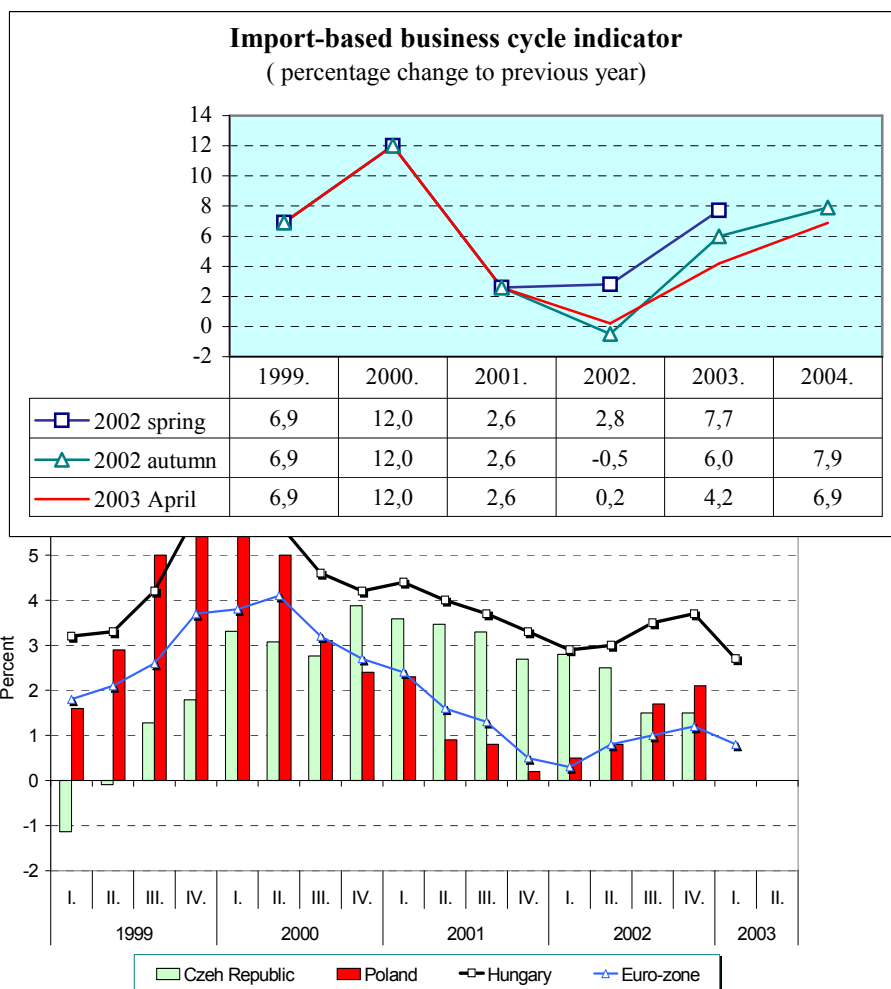
¹ The key facts and figures in monthly breakdown are included in the table 1 and table 2, the data of macroprojection are presented in the table 3 while growth trends of the world economy is covered by the table 4.

The economy of the **European Union** and that of the Euro zone stagnated in the first quarter of 2003 compared to the fourth quarter of 2002. That is, the GDP rose by 1.0 per cent in the 15 Member States and by 0.8 per cent in the Euro zone in comparison with the same period a year earlier. For 2003 as a whole, economic growth is projected to reach 1.3 per cent in the European Union and merely 1.0 per cent in the Euro zone. The international agencies have made significant downward adjustments to their projections. While domestic demand has become the key driver of growth, households' consumption did not continue to strengthen. In 2002, households increased their consumption by only 1.4 per cent and 0.7 per cent in the European Union and in the Euro zone, respectively. The higher-than-expected inflation deteriorated the purchasing power of incomes, poor job creation moderated the real disposable income, while continuing drop in share prices curtailed households' net worth further. In addition, uncertainty lowered confidence indices and stimulated savings. Both consumer and business confidence indices projected still only a slow growth for the first half of the year, but a recession all over Europe is a scenario unlikely to happen. However, Germany is expected to stagnate or grow but very slightly. The strengthening of the euro is also a cause of concern in terms of recovery. Exporters in the region will probably lose of their share on the world market.

The European Union is stagnating

The long-standing general uncertainty about global economic situation is well indicated by the fact that forecasts made by international agencies in the recent two years about import demand in certain countries or groups of countries has been changed from time to time and has become more and more pessimistic for the same period. Likewise, the OECD projections about the German import demand, the main export market for Hungary, fell by more than 3 percentage points and 1 percentage point for 2003 and 2004, respectively. The latest import-based indicators of business cycle published by the OECD at the end of April are still unfavourable compared to those of fall 2002. Thus, Hungary's export prospects may further deteriorate from the assumptions that have been accepted until now.

*World economic outlook is still uncertain.
Hungary's export prospects are not likely to improve*

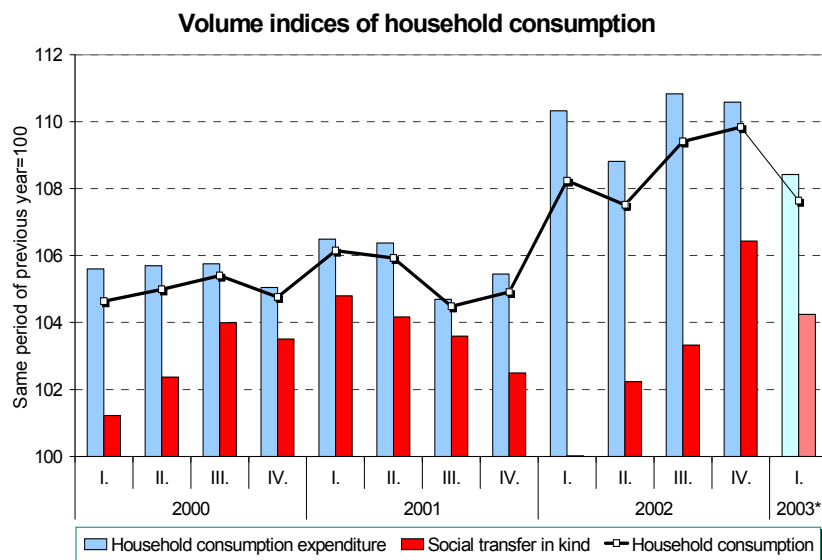


2. Growth

Based on preliminary information by the Central Statistical Office (CSO), the gross domestic product increased by 2.7 per cent in the first quarter of 2003. The continuous acceleration of economic growth as observed in 2002 stalled in the first three months of the year. The rate of growth has never been so low since the first quarter of 1997. The declining economic performance was due in particular to adverse external market developments. GDP growth also suffered a slowdown in the countries with the highest trade relevance for Hungary.

GDP grew by 2.7 per cent in the first quarter

The structure of GDP remained unfavourable. Last year, it was first of all consumption and government-generated investments that led economic growth at a rate considered still high by international standards. However, in the first quarter of 2003, only the consumption drove the economic growth.



Due to a significant earnings outflow, the household consumption increased to a large extent, by almost 9 per cent in 2002 as a whole. In the first quarter of 2003, consumption is estimated to continue increasing dynamically due to carry-over effects, but at a lower pace than last year as witnessed by the significant rise in retail sales in the first quarter. For the rest of the year, this dynamics will have a modest slowdown. In 2003, the households' consumption could, even so, be somewhat higher than prognosed in the Flash Report for 2003 March to reach close to 6 per cent.

Dynamics of consumption is still higher than that of the GDP but at a slackening pace

Investments on national economy level increased largely – by 5.8 per cent – last year due particularly to the rise in the public investments. Business investments, however, showed low activity throughout the period in line with the unfavourable external demand and the deteriorating competitiveness.

Investment activity got moderate in the first quarter

Based on CSO preliminary figures, the volume of investments fell by 1.2 per cent in the first quarter of 2003. Behind the mitigated investment activity, there was a trend adverse to the last year since in the first three months, business investments significantly picked up while the public sector investments seemed to decline. The extraordinary cold weather had also part in decelerating public investments and construction, in addition to a high statistical basis.

Manufacturing investments being most relevant to economic growth rose by 4.4 per cent from which it is concluded that the manufacturing sector has, to all probabilities, turned the corner of 2002.

Manufacturing investments resumed to increase

With further growing of business investments and the resumed recovery of housing activity, it does not seem unrealistic to achieve a rate of growth of about 5 per cent for the rest of the year. Thus, our investment projection of about 4 per cent for 2003 as a whole remained essentially the same.

From the second half of 2001, the companies significantly unbuilt their inventories in response to the global recession. In the first six months of 2002, unbuilding stocks further continued the process of which greatly declined in the third quarter to be replaced by a smaller replenishment of stocks in the fourth.

In 2003 modest replenishment of stocks

In 2003, this smaller replenishment of stocks seems to be plausible in accordance with our previous forecast and counting on further recovery of external business environment.

Due to a slow progress of external economic upturn and the decline of tourism, the growth of export of goods and services decelerated in the second half of 2002. In this context, a few companies with significant export volumes had a part by stopping their activity in Hungary.

Export slump

In the first quarter of 2003, the evolving trends of the second six months continued. Also, proceeds from tourism continued to fall due first of all to the war in Iraq and the SARS virus implications. Modelling calculations prepared on the basis of the latest projections published in April by various international agencies indicate further decline in our export markets compared to the former projections. Therefore, our export estimate was adjusted downwards from the previous Flash Report to the range of 3 to 5 per cent.

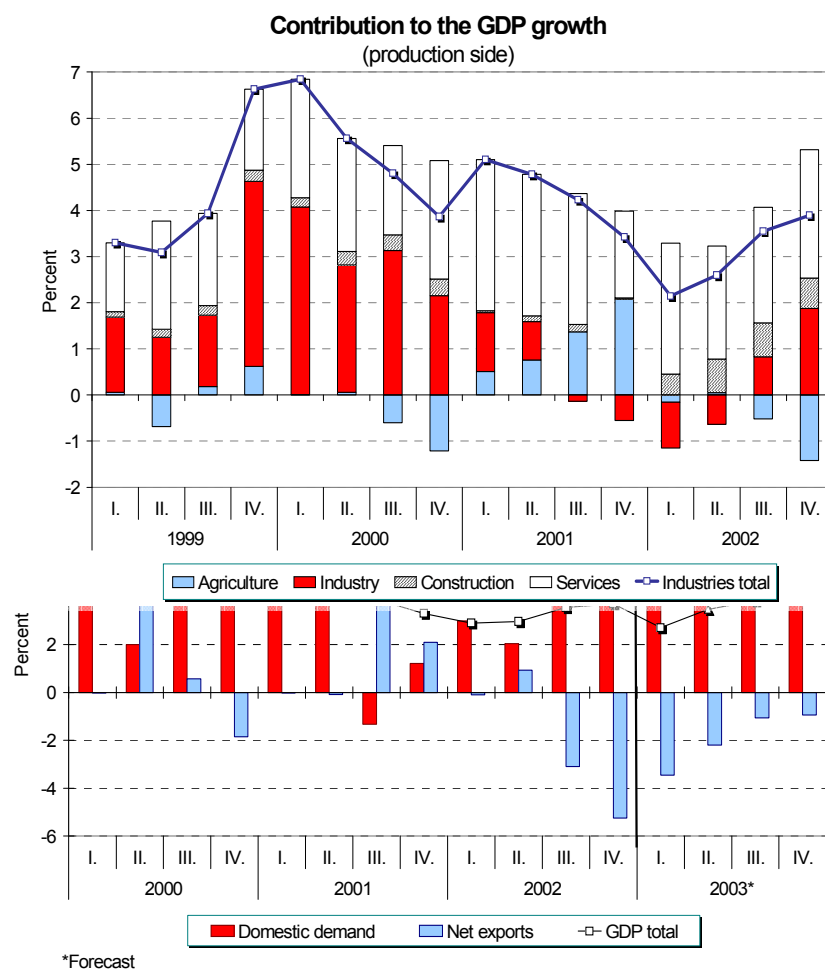
In the first quarter, the imports could grow 4 to 5 per cent due to the jump in households' consumption as a result of pay raises in 2002 and recovering investments in the manufacturing sector as well as stockpiling activity. Based on a lower growth of exports and taking into account high imports content in the exports, our annual forecast was adjusted downwards to 5 to 7 per cent.

Significant import growth

In the output structure of GDP, added value of services and construction dynamically expanded as observed throughout the whole year of 2002. At the same time, agricultural performances trailed behind the year 2001 because of bad weather and high reference figures. Declining added value for industry including manufacturing stopped in the third quarter to make a positive contribution to economic growth in the second six months.

In the first quarter of 2003, gross value added in the services sector further increased while agriculture and construction saw a fall due particularly to the cold weather. Value added of industry hardly changed. For the rest of the year, quickening is expected in every sector.

Value added of construction mitigated



The expected GDP growth at 3.5 per cent for 2003 as a whole can be achieved only if both exports and business investments will largely pick up in line with external demand improved. To this end, improving competitiveness of companies should be indispensable as well as the acceleration of global economic upturn. Thus, economic policy measures are needed to put improved competitiveness at the forefront.

For 2003 as a whole, economic growth is expected at 3.5 per cent

2.1 Wages and earnings

Gross nominal earnings of full-time employees on a monthly average of national economy rose by 15.2 per cent in the first quarter from a year earlier. The growth rate was 8.8 and 27.3 per cent in the business sector for the enterprises staffed at 5 at least and public sector, respectively.

In the business sector, pace of wage rise has been slowing down

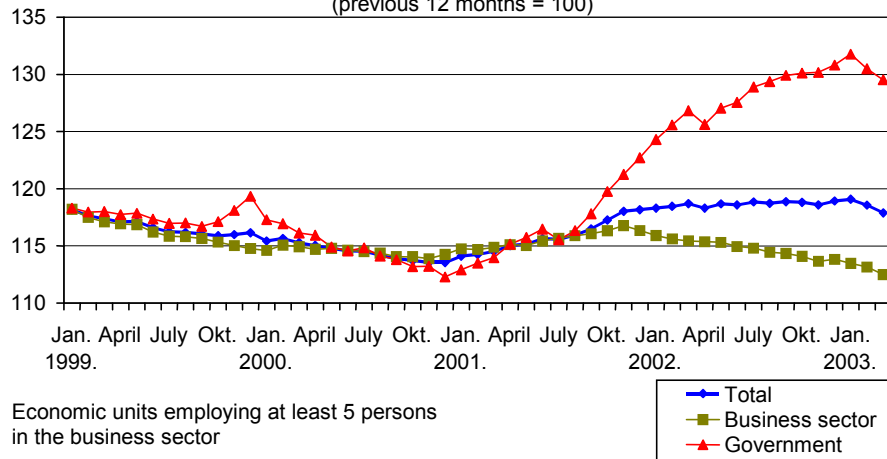
**Monthly average earnings of full time employees
in the first three months of 2003.**

Q1 of the previous year = 100

	Total
	Business sector
	Government
	2002
	2003
	2002
	2003
	2002
	2003
Gross average earnings	
	119,4
	115,2
	114,1
	108,8
	132,6
	127,3
Net average earnings	
	118,7
	118,9
	114,6
	114,7
	129,1
	127,0
Real earnings	
	111,8
	113,7
	107,9
	109,7
	121,6
	121,4

Average earnings during the last 12

(previous 12 months = 100)



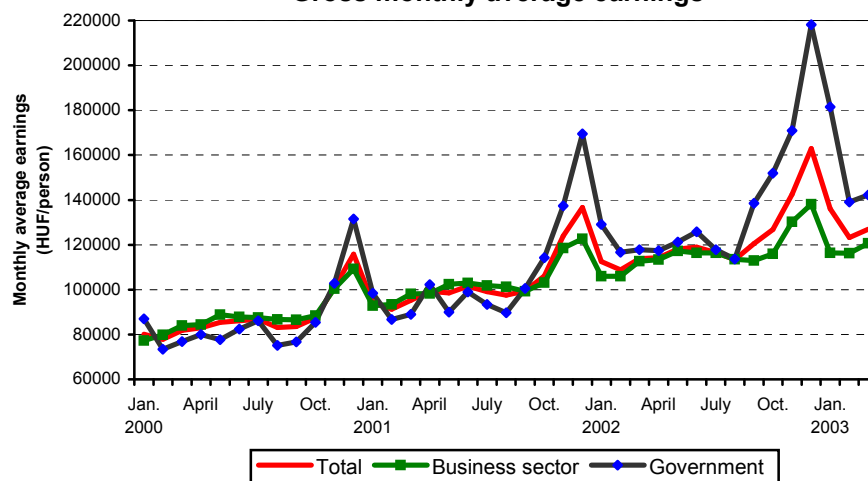
The 12-month index of gross average earnings in the business sector was free of major fluctuations in the recent years, starting to permanently plunge from the third quarter of 2001. Wage development has been therefore better adapted to the inflation brought down and changes in productivity. The impact of last year's wage measures in the public sector explains the jump in the index and the pay rise much higher than that in the business sector.

This outstanding rise in the gross earnings seen in January by the public sector slowed down in February and March (January: 40.8 per cent; January to February: 30.9 per cent). Seriously increased gross earnings in January are explained by two factors:

- Though the gross minimum wage did not increase from 1st of January, minimum wage for graduates was introduced in the public sector (HUF 100,000 per month);
- Carry-over effect of the last September pay rise for public employees including the so-called "salary for the thirteenth month" appeared as double in January.

Public sector continued to see fast-growing earnings

Gross monthly average earnings



Change of net earnings was almost equal to the figures of the first quarter of 2002. In the first quarter of 2003, the growth rate of earnings in gross and net has been deviated to the benefit of net earnings growth because the rate of tax credit increased from September 1 of 2002. Net earnings on the average of national economy rose by 18.9 per cent in the first three months faster than gross ones by 3.7 percentage points. Net earnings indices were higher than those of gross earnings in every branch of business sector. Thus, real earnings increase was more than twice higher than the recommendation (4.5 per cent) made in the National Interest Reconciliation Council for 2003.

Net earnings grew faster than gross ones in every branch of business sector

Real earnings of full-time employees (with a consumer price index increased by 4.6 per cent) exceeded by 13.7 per cent the figure a year earlier until March. In the business sector real earnings rose by 9.7 per cent and in the public sector by 21.4 per cent - almost the same as had been last year.

Real earnings increased faster than productivity

Despite the deceleration of gross earnings pace, the competitiveness of Hungarian economy deteriorated in the recent two years since earnings growth and thereby that of labour costs significantly surpassed productivity gains, endangering economic stability.

National economy-wide gross earnings in 2003 will expand by 11 to 12 per cent in our forecast. Based on corporate wage settlements, it is not completely clear whether the rate of business sector's earnings growth will continue to slow down in the rest of the year. From the trend of former years and employers' expectations in combination it is concluded that the annual average gross earnings will be higher by 7.5 to 8.5 per cent than in 2002 for the business sector. However, more accurate information could only be available if we have the details of the next quarter.

Gross wages are expected to rise 7.5-8.5 per cent in the business sector

In the public sector, change of gross wage bill may go above 21 per cent on an annual average from a year earlier since growth rate of gross earnings is not expected to plunge under 19 per cent, and the number of those employed in the public sector will increase even on the average of the year.

Change of net earnings will probably surpass that of the gross ones in every sector. On a national economy-wide basis, the difference will make 4 to 5 per cent. Real wages will rise well over productivity by 10 to 12 per cent.

2.2 The employed and the unemployed

Based on CSO institutional statistics, the number of employed by enterprises staffed at 5 at least as well as those with government and social security agencies increased by 0.6 per cent. Within this, the number of employed in business sector fell by almost 0.7 per cent while the number of employees in the public sector rose by 3.7 per cent.

Number of employed rose

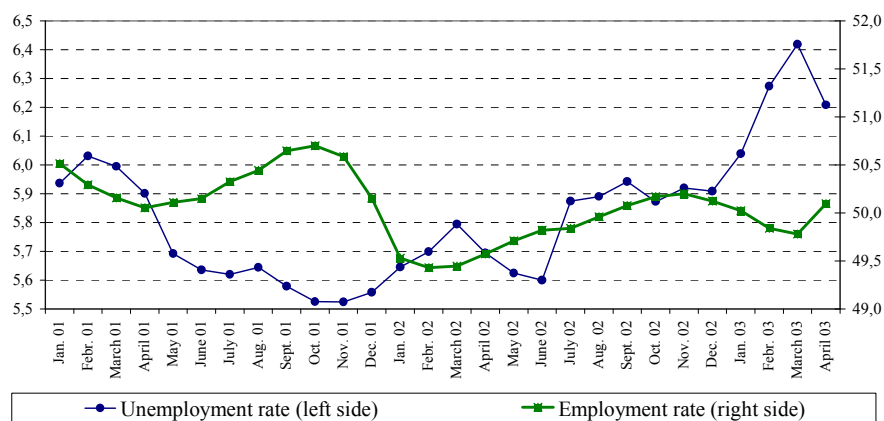
In the age group from 15 to 74, the number of economically active persons (total amount of the unemployed and employees) rose approximately by 1.2 per cent in the first quarter compared to the same period of last year. The participation rate was 53.2 per cent, which improved by 0.2 percentage point on a three-month average including April, thus exceeding by 0.8 per cent the figure measured in the same three months of 2002. In addition to increasing number of employed, the favourable rate was due to the fact that more people sought jobs and the falling number of those in the age group from 15 to 74.

The number of economically active persons increased

In the age group from 15 to 74, the number of employed increased by 0.5 per cent in the first quarter of 2003 from a year earlier. Within this, regional readings show descending numbers of the employed in Western Transdanubia and Southern Great Plain. The employment rate also improved in the range narrower than the age group above: in the group of women and men of working age, employed were 59.8 per cent. The participation rate in the age group from 25 to 54 reached more than 70 per cent. Both below and above this age group, the ratio of registered as employed in the labour market was strongly worse.

Number of employed was up by 0.5 per cent

Employment and unemployment rate
of the population aged 15-74 from January 2001. (%)



Based on CSO survey, average number of the unemployed was 25,000 higher than the figure published for February to April of 2002 or 12 per cent more. The rate of unemployment was 6.2 per cent on the average of the last three months. The rate of unemployment as of the beginning of the year (about 6.3 per cent on the average of the first four months of 2003) continuously diminished from the rate run up (January: 6.6 per cent) early in the year.

In the first quarter, the rate of unemployment was 6.4 per cent

The unemployment rate – 13.6 per cent – of the youth (15 to 24 years of age) for the last three months was still higher by 2.1 percentage points than a year earlier. Thus, it still stood high even though showing a somewhat more favourable picture in relation to the deteriorating tendency of the former months. (The rate relating to the same age group of EU countries was 15.8 per cent in March)

The registered unemployed made 368,000 in April-end or 20,000 more than had been last year but at the same time, lower by 20,000 than in February.

The ILO unemployment rate is expected to be around 6 per cent on an annual average. The number of employed will modestly rise in 2003. Last month, the indicators of labour market made good progress. In particular, the unemployment rate plunged, employment rate and participation rate increased. This is a cause of confidence even if final conclusion should not be drawn from one month's favourable figures until those for several months are available.

2.3 Consumption and retail sales

Based on recent CSO figures of national accounts published in April, **household consumption** and its components strongly rose in 2002:

Household consumption by quarters

(Index: corresponding period of previous year = 100)

14

	Q 1	Q 2	Q 3	Q 4	Year
Consumption expenditure	110,3	108,8	110,8	110,6	110,2
Transfer in kind	100,0	102,2	103,3	106,4	103,0
Total	108,2	107,5	109,4	109,8	108,8

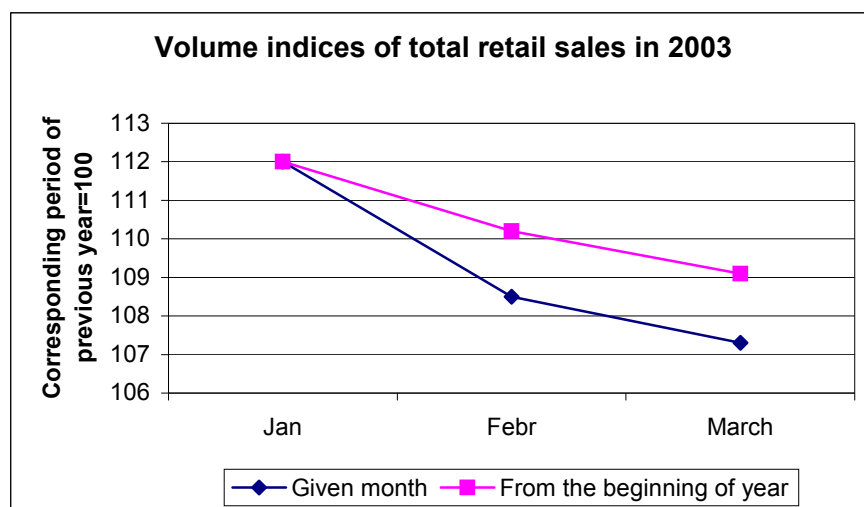
The growth rate of consumption in 2002 was not even. In line with the acceleration of dynamics of the real wage and real income, the growth of consumption was stronger in the second six months of 2002. It was the dynamic earnings outflow, weakening inflation and diminishing propensity to save resulting in a considerable increase of consumption.

The growth rate of consumption accelerated in the second six months of 2002

In the first quarter of 2003, the volume of **retail sales** continued to grow fast, although more modestly than last year. Sales volume excluding vehicle and fuel sales, adjusted for working days and seasonal effects increased by 9.9 per cent compared to the same period of last year. Within this, sales of nonspecialized stores (19.7 per cent), textile, clothing and footwear (18.1 per cent) as well as mail orders increased at an outstanding pace.

Growth rate of retail sales lowered from 2002

Total retail sales volume without adjustments exceeded by 9.1 per cent the last year's figure for quarter 1. Growth rate has been slowing down from month to month:



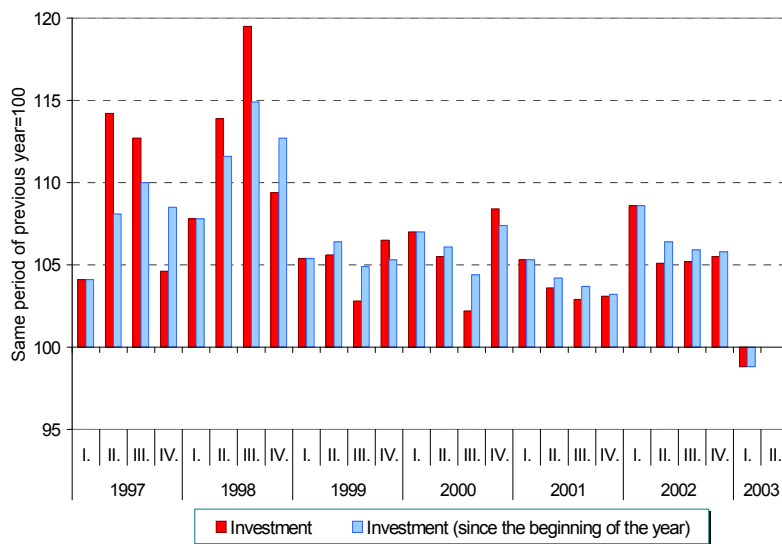
Upon the carry-over effect of last year's measures done away, the pace of wage outflow will mitigate in the second six months. Thus, it is estimated that the pace of households' consumption will also fall while remaining relatively high – 6 per cent – even so.

2.4 Investments

In the first quarter of 2003, the volume of national economy investments fell by 1.2 per cent from the last year's first quarter, based on CSO preliminary figures. From the previous quarter – the last year's quarter 4 – the fall was 1.9 per cent according to the index seasonally adjusted.

In the first quarter of 2003, the volume of investments fell by 1.2 per cent

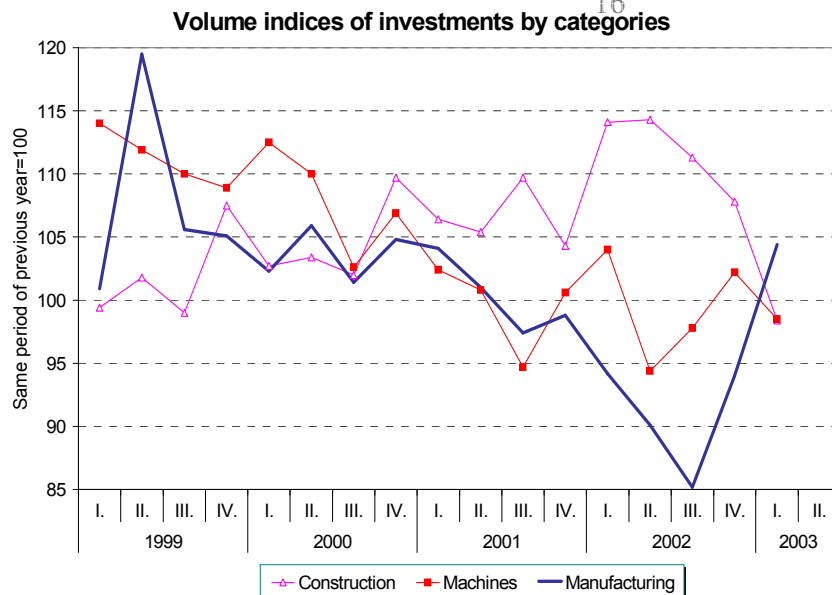
Volume indices of investment in the national economy



Behind the adverse volume shrinking, the composition of investments changed for the better. Last year, the increase of investments on a national economy-wide scale by 5.8 per cent was produced in a very bad composition. In particular, investments in the public sector expanded very dynamically while business investments declined by 2 to 3 per cent. In the first quarter of 2003, the composition turned for the better, however. Most marking carriers of the favourable change were two branches of national economy: investments in the public administration and manufacturing investments. The volume of investments in the public administration increased by 32.2 per cent while those of the manufacturing sector fell by 9.2 per cent. In the first quarter of 2003, investments in the public administration declined by 38 per cent while manufacturing investments expanded by 4.4 per cent.

The drop in volume of investments brought an improved composition thereof: business investments rose while public investments fell

Also remarkable in terms of restructuring is the fact that the volume of investments rose almost 25 per cent in the agriculture and 30 per cent in financial services. The growth of healthcare and welfare investments by 16 per cent was left below the half of last year's figure (quarter 1: 35 per cent). At the same time, the volume of investments fell by 15 per cent in the sector of transport, storage, postal and telecom services due partly to weather conditions. The sector of other community, personal services also saw a decline due to the rationalization of public expenditures. Housing activity was stalling because of the high reference figures and weather conditions scored by the increase in volume by 8 per cent of real estate industry investments following the last year's 15 per cent.



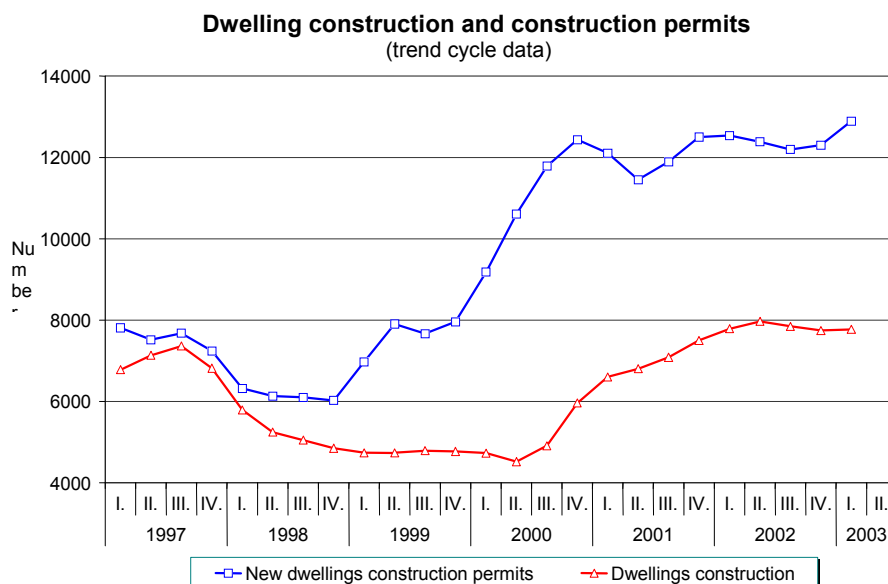
In overall terms, the investment details of the first quarter in 2003 refer to a shift towards the sustainable growth. It is likely that business investments stopped to decline while public investments saw a marking plunge and the households contained their investments. For the latter, that is, housing activity, the long winter could well play a key role hindering particularly building investments, which were still dominating. The first quarter investments made up an eighth of annual performance on the average and at current prices. However, the last winter, unusually long and cold, was likely to reduce this ratio.

First quarter investments have been determining for the year as a whole while the changes to the composition being in favour

Behind the plunge in volume of investments by 1.2 per cent stood building investments (-1.6 per cent) and machinery investments (-1.5 per cent).

In our prognosis, the volume of investments will increase by approximately 4 per cent in the year. The composition is expected to improve from the last year. In conjunction with economic recovery deemed to start in the second six months of 2003, the businesses should grow as estimated. As a sign of this process, the expansion of manufacturing investments by almost 4.5 per cent must be warning. Due to the measures to improve balances and the reference figures as outstanding as high, significant decline in pace is assumed in the public sector while households will further and largely increase their housing activity, also evidenced by the increasing number of housing licences issued in the first quarter. Although the number of homes released fell by 7 per cent in the first quarter it must be transitional as a result of bad weather.

In 2003, the volume of investments will grow at approximately 4 per cent



The investment ratio projected to increase in volume by 4 per cent will however go down to 22 per cent in 2003 as a whole. Over the year, stock-unbuilding will be replaced by stock-building. Thus, the volume of accumulation is assumed to exceed that of the investments.

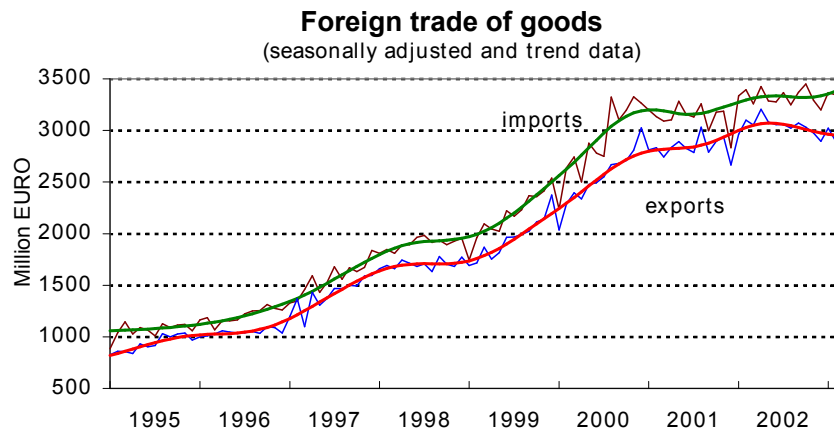
The investment ratio will go down to 22 per cent while the volume of inventories and accumulation going up

2.5 Foreign trade

Thus far in 2003, the tendencies developed in the end of last year continued. The dynamics of trade has weakened. Between export and import dynamics there was a negative pace difference of 3 to 4 per cent. The balance of trade in goods deteriorated by more than EUR 400 million to EUR 1.2 billion compared to the same period a year earlier. The volume of imports showed a dynamic increase only in food products (11 per cent). Furthermore, import growth of manufactured products exceeded somewhat the modest average growth (4.3 per cent). Exports have essentially stagnated (increased by 0.4 per cent). While engineering and equipment exports have produced a relatively dynamic expansion (almost by 9 per cent) exports of manufactured products was less by more than 12 per cent than had been a year earlier, mostly as a result of some export goods shortfall such as video games, IBM export eliminated bringing about a drop in Hungary's 2003 export by some 5 per cent.

In foreign trade, the tendencies of 2002 last quarter have continued

The expansion of external demand, assuming certain gradual improvement of the advanced countries' economic situation, will not surpass the modest rate of 4 to 5 per cent for the whole year. Under a continuing fast consumption growth and the modest export increase indicated above, imports are estimated to produce a modest growth alike. For such export and import figures, the trade balance may worsen by EUR 700 to 800 million. The deterioration may still be worse in case of a delayed economic recovery (with an export dynamics still worse than indicated).



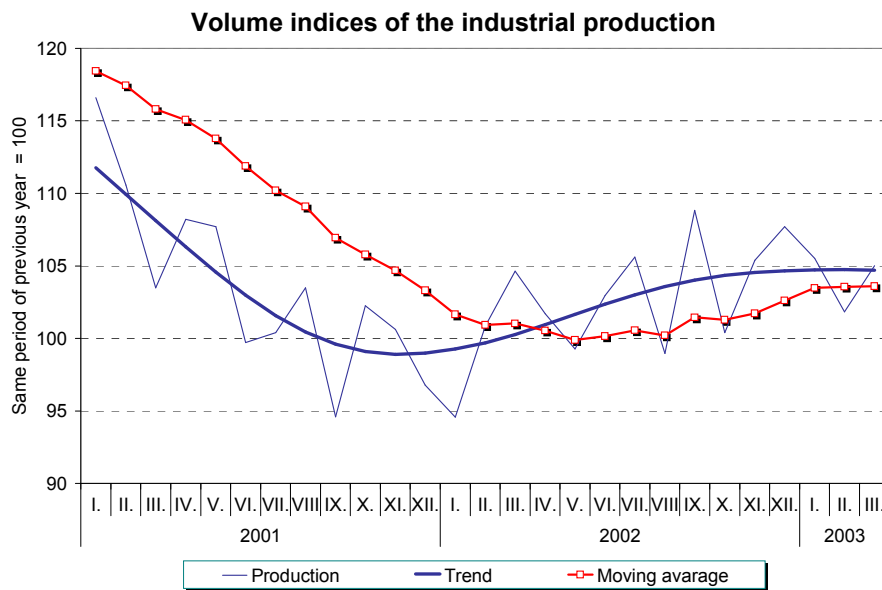
In the first quarter of 2003 on a relation-based approach, Hungary's exports for the European Union remained unchanged in volume while imports from there increased by 4 per cent. To the largest extent, the volume of trade with the Central and Eastern European countries. Exports and imports in this relation rose 12 and 9 per cent the level of the previous year's first quarter. The rate of export growth exceeded that of the imports solely in this relation.

We have had still an active balance – although to a decreasing extent – in the trade with the advanced countries while the balance with developing and Eastern European region has been passive.

2.6 Production

Industrial production rose by 4.4 per cent in the first quarter of 2003 compared to 2.6 per cent in 2002. However, the detailed analysis cannot deliver a picture so clear and promising. It was fundamentally the energy-producing sector to drive this growth since *the cold weather in February and March, much harder than usual, significantly raised the requirement for energy supply*. This shift is reflected in the fact that the weight of energy supply in the industrial production lifted from 11 per cent in the first quarter of 2002 to 12.5 per cent this year.

Increasing energy needs strongly influenced the growth of industrial production



The volume of industrial production per capita rose by 7.8 per cent (under staffing cut by 3 per cent) while productivity of manufacturing sector was 1.2 percentage point left behind that.

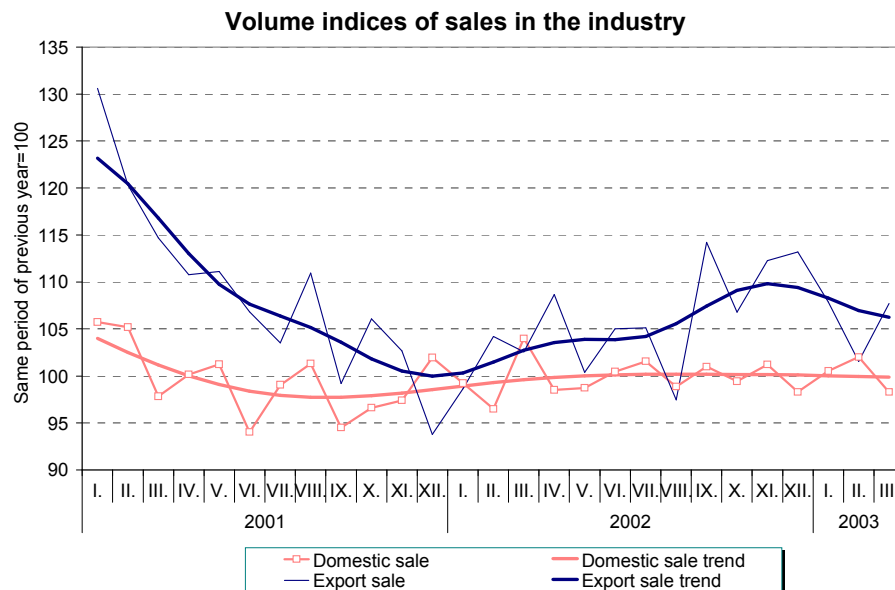
Industrial productivity gains were almost 8 per cent

External market demand for industrial products was more sluggish compared to the last quarter of 2002 but still 7 percentage points higher than the low level in the first quarter in that year. Although export orders stock was equal to that last year's, new export orders including particularly traditional engineering branches rose by 22 per cent. Also, it should be a positive development that export price indices of these engineering branches seemed to be stabilised (slightly increased against the former trend of continuous fall).

New export orders of industry are a cause of cautious optimism

Domestic industrial sales increased by 0.8 per cent in the first quarter while it was only a consequence of domestic energy consumption increased to an extent well above (14 per cent); domestic sales in the manufacturing sector fell by 3.5 per cent at the same time. The graph below shows monthly, data of industrial sales based on seasonally adjusted indices.

Domestic sales increased due to raised energy consumption



Manufacturing output rose 3.5 per cent in the first quarter of 2003 compared to a quasi-stagnation last year. For many years it was the first occasion that manufacturing output trailed nearly 1 percentage point behind the industrial one. The growth was due to manufacturing sub-branches operating particularly with up-to-date technology, which represent somewhat more than a half the sector such as vehicle industry, electricity engineering and machinery and equipment. Food industry with an eighth of industrial production fell by 3.7 per cent unlike the last year's growth at 5 per cent in the first three months in that year. Crisis in the leather industry further deepened. Following the decline in the first quarter of last year, its output decreased to three fourth of that volume.

The increase of manufacturing output was left behind that of the industry

Domestic manufacturing sales (every month left behind the level of previous year) fell by 3.5 per cent in the first three months of the year from 2002. Vehicle industry's domestic sales increased at an outstanding pace in every month of the quarter with a quarterly total of 27 per cent. Domestic sales data of electricity engineering and instruments showed increasing dynamics from month to month, nearing 6 per cent on a quarterly total. It was unfavourable that domestic sales of machinery and equipment stagnated in the first quarter. Domestic sales of building material industry strongly shrank by more than 20 per cent, due assumably to the construction cycle. Domestic sales of food industry making a third of overall domestic turnover was 5.7 per cent lower than had been in the previous year.

The range of paces of domestic sales in each branch was rather wide

The **volume of manufacturing export sales** increased by 7.2 per cent in the first three months of 2003, raising however proceeds of exporting companies by only 4.4 per cent at current prices. It was electricity engineering, machinery and equipment (55 per cent) as well as vehicle industry (38 per cent) to realise the determining share of this growth at current prices. Three quarters of manufacturing output growth went to foreign markets although its average sales ratio in external markets earlier moved around 60 per cent, that is, the exports' pulling power on production rose in this regard. Paces of export sales by branch do not show so extreme figures as do domestic sales. Branches making up paces of exports sales of 6 to 12 per cent produced nearly 80 per cent of manufacturing output in total.

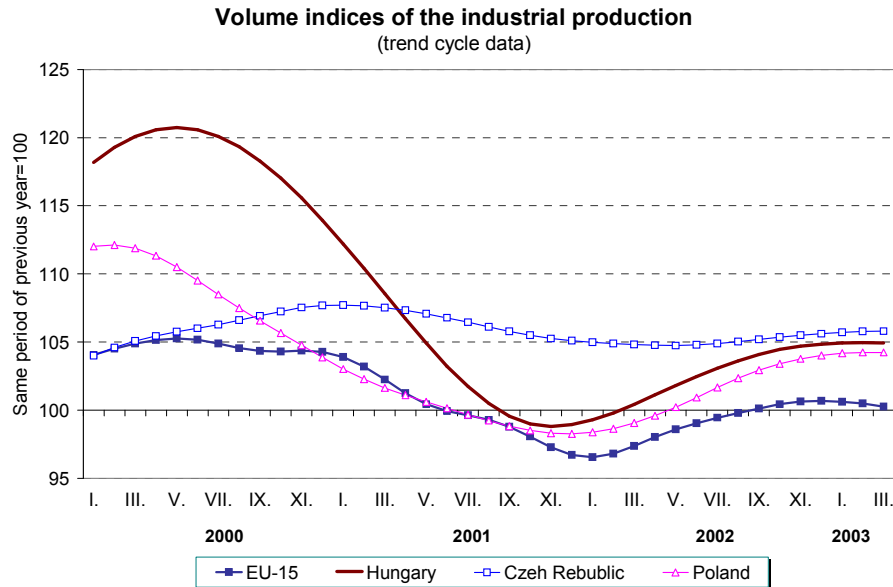
Manufacturing industry was increasingly export-led

General economic downturn affected the large international companies as well. The primary reason of the fact that the corporate sector was net saver last year was just containing dynamic investment activity by foreign-owned corporations or enhanced stocking economy. Regional re-arrangement also continued in the year to maintain efficiency and competitiveness or even to improve those. There were certain businesses, mostly with mass production, dislocated their activity, partly or wholly, or expected to dislocate it into geographical zones having more favourable conditions for the purpose. At the same time, other (or the same) multinationals decided, based on Hungary's geographical benefits, skilled labour, predictable economic policy and possible advantages from the upcoming EU accession, to locate their various regional services or research & development centres here (e.g. Knorr-Bremse, GE, Alcoa, Samsung, BASF). These enterprises consider Hungary as a strategic destination on a wider perspective provided that we maintain our advantages. Hungarian national economic interests coincide with this process since foreign capital so involved will carry a higher share of value-added contents.

Signs of changing policy are observed in the foreign-owned corporations

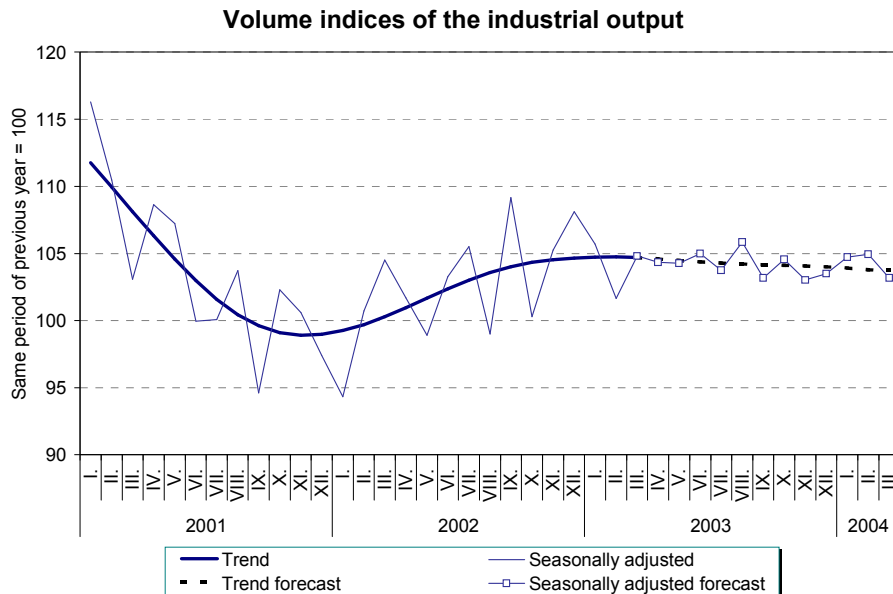
The effect of dragging economic recession was seen in the industrial production of the region as well. In the previous Flash Report, the outlines of a recovering production growth could be assumed. For the first quarter of 2003, however, the paces essentially decelerated to various extents.

Pace of growth also decelerated in our region



Since the outstanding output growth in 2000 industrial performances were definitely stalling. International economic downturn was primarily accountable for the deceleration of pace. Nevertheless, certain domestic measures, which were partly necessary, also deteriorated the conditions. E.g. raises of minimum wage made reprocessing more expensive while strengthening HUF exchange rate negatively affected the exporting companies that could not offset the adverse impacts with the benefits from imports. Exporting firms using domestic raw materials suffered sensible losses. In contrast with our expectations, raising domestic demand did not induce real growth of industrial production in the domestic industry with the exception of vehicle industry. For the rest of the year, production growth of industry is first of all expected from the expansion of manufacturing activity, and, in another aspect, from widening export opportunities. In case of recovery started, the industry could produce an annual production growth even at 6 per cent for 2003. If not, we cannot count on an industrial growth higher than 4 to 4.5 per cent.

Growth of industrial production depends on the economic situation in the world market



After the outstanding growth of **construction** in 2002 (by 20 per cent), a decline for 2003 could be considered almost necessary, partly as a result of that high reference level. A further and unpredictable factor was a very cold weather that hindered construction works, the role of which was determining. As a result of the foregoing processes, construction performance was 13.5 per cent lower in the first three months of 2003 than had been the last year's outstanding dynamics. Growth rate of ready-structured constructions representing 55 per cent of construction production was falling from month to month. As a result, it trailed in March more than 30 per cent behind the previous year. Its first quarter performance was only three quarters of 2002 first three months. Adaptation skills of construction were manifested in the growth of assembly works more or less independent on the weather at 7 per cent.

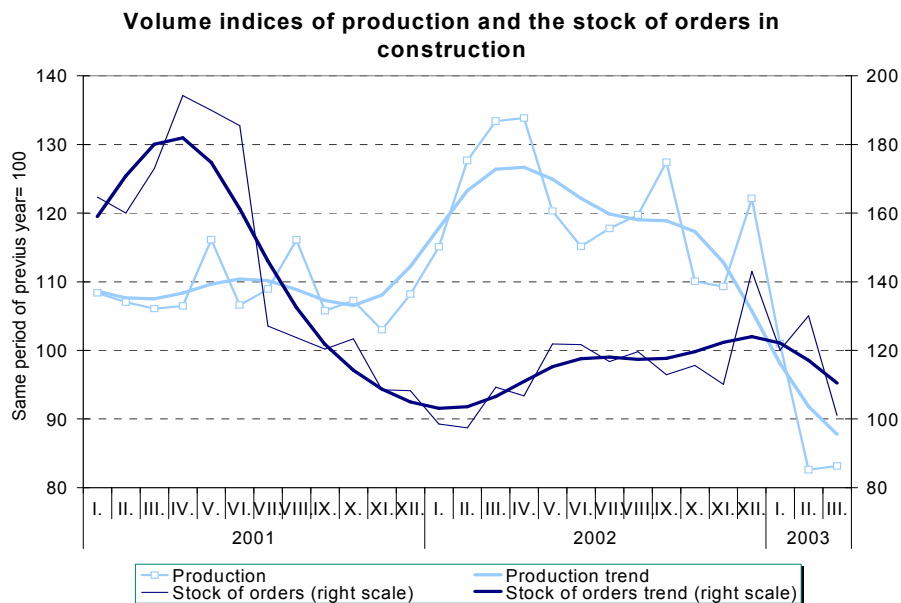
Construction production declined

The pick-up in new orders stock experienced in March 2002 did not resume this year. The new orders' stock piled up from the beginning of the year was HUF 180 billion lower than had been in the previous year's March, not achieving even a half the volume in the year 2002. The total orders' stock, which showed an encouraging pace last month, was almost 8 per cent left behind the figure a year earlier.

The new orders' stock is not encouraging

Assessing the construction's 2003 performance is exposed to a lot of uncertainty. Weather conditions can be disregarded from April, reference levels that high would however have their impact throughout the year, though to a diminishing extent. Also, it is a question how much the pick-up of private housing activity on soft loans could offset the weaker performances by large public projects and local governments' infrastructure investments. Information on the next quarter's orders could greatly influence our projection for construction output. According to experts production may even grow at about 10 per cent in the year.

It is hard to assess the construction performance in the year



Based on CSO's recently published data of the **agriculture** in 2002, the sector's production value and gross value added decreased by 4.4 and 12 per cent, respectively, from the previous year. Within this, crop farming output fell by 11 per cent while animal husbandry went up by 2 per cent. (The latter's current revenue in HUF was 4 per cent left behind 2001 due to falling prices.) Production value of non-farming secondary activity, making only 3 per cent of agricultural output, was less (by 4 per cent) than in the previous year. As was indicated in the recent Flash Report, the main reason of decline in crop farming was the poor yields on cereals, which could not be offset even by the increasing volume of industrial crops and garden products. In addition, for fruits the last year's April frost caused a shortfall of some 26 per cent in production.

Performance of agriculture trailed behind the outstanding level in 2001

Procurement of agricultural products rose by 1.4 per cent in the first quarter of which sales of vegetable products fell by nearly 20 per cent at prices increased by more than 4 per cent; sales of animal products rose by 6 per cent at the same time their, average prices fell by 5 per cent. Procurement of wine-grape, wine-mash and wine, which were available in large amounts, achieved nearly a double figure while the related prices also increased by almost 20 per cent. 2003 outlook is not very promising. The strong cold caused damage that is not measurable today to particularly the orchards and grapes in certain fields. The springtime drought may question the efficiency of crop farming. The nature can be protective against these effects, therefore and due to the low reference level, the agriculture's 2003 increment on performance is thought to about 3 per cent.

Procurement of agricultural products increased. 2003 performance may bring a surplus of 3 per cent or more in case of better weather conditions

In the first quarter of 2003, enterprises in the **transport sector** delivered goods in an amount less by 14 per cent than in 2002. The performance measured in tons of goods and kilometres fell by 5 per cent. Within this, railways and road traffic realised a decline by 20 and 5 per cent, respectively. All this is a reflection of building and investment activity declined because of the cold weather. Distance passenger transport went down by 3 per cent while the number of passengers in local public transport rose by 2 per cent.

Transport performance fell

3. Monetary flows

3.1 Measures by the Central Bank

Following having beaten off the speculation charge to force a stronger exchange rate of Hungarian Forint, the situation was settled. The monetary arsenal reactivated by cancelling transitional modifications was in operation with unchanged conditions. The governing rate of two-week Central Bank deposit rate was 6.5 per cent with an interest rate path was +/- 1 per cent. Rate of legal reserves was 5 per cent while the interest rate payable by the Central Bank on legal reserves was 5.75 per cent since its increase in January.

Since having prevented the speculation the Central Bank did not change monetary conditions

Until 23 May 2003, the National Bank of Hungary could sell the amount of EUR 5.3 billion in more than 70 per cent (some EUR 3.8 billion) which had been forced to buy in mid-January by means of open, and then silent intervention thereby achieving that the foreign capital for speculative purposes leave the domestic banking system without jeopardising the HUF exchange rate and the stability of financial system. Speculative foreign capital outflow was partly - in amount of EUR 1.2 billion - implemented indirectly, that is, to hedge against their exchange rate risks, market players bought HUF sold by the speculators, rather than NBH. Accordingly, the speculative positions turned into hedging positions (The rest of EUR 0.2 billion was a profit on exchange rate by NBH or, in other words, the loss by the speculators.)

The exchange rate stability was secured by the Central Bank's active presence in the FX market until the foreign capital for speculation purposes had left

The Central Bank announced on 26 May 2003 to suspend practices of intervention within the band and return to its former policy of influencing the exchange rate within the band by interest rate cuts or hikes in particular.

The Central Bank suspended intervention within the band

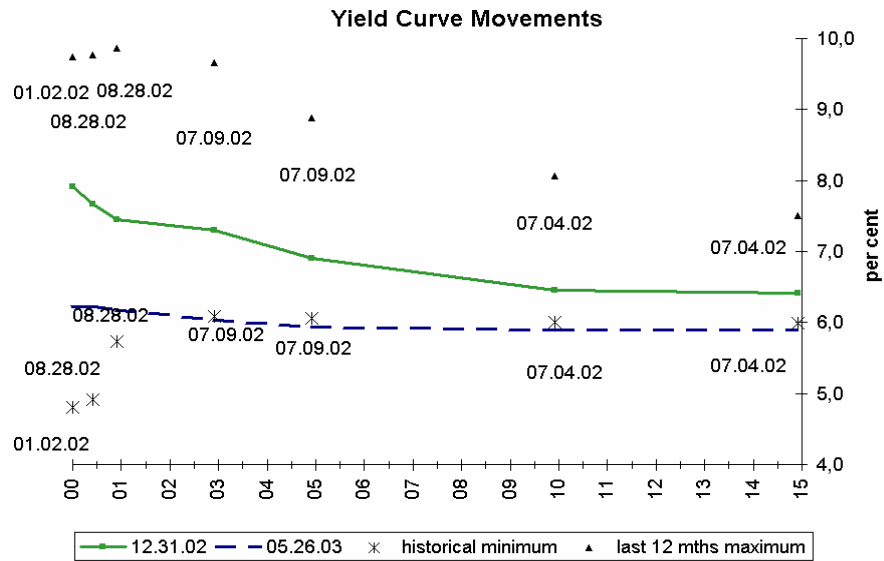
The Government, in agreement with the National Bank of Hungary re-specified HUF central parity at HUF/EUR 282.36 with effect from 4 June 2003. Width of fluctuation band is +/- 15% including the new edges have been HUF/EUR 240.01 and HUF/EUR 324.71.

Central parity of Hungarian Forint was modified with the fluctuation band unchanged at +/- 15%

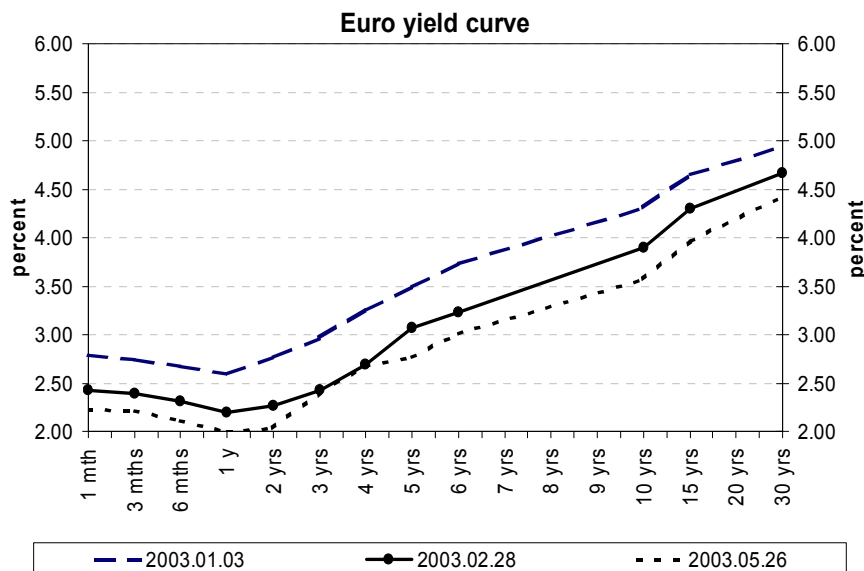
3.2 Yields and interest rates

After the central bank means had been restored on 24 February the yield curve became practically horizontal. Although there were little shifts, and then corrections in the recent months, the overall trend was declining in the yields. Short-term yields were brought in line with the base rate, after a significant difference from November 2002 on. Since March, a roughly 25-basis point cut in base rate had been priced in the yield curve. Due to diminishing long-term yields, the current level could meet Maastricht interest rate criterion.

Since March, the yield curve has been practically horizontal

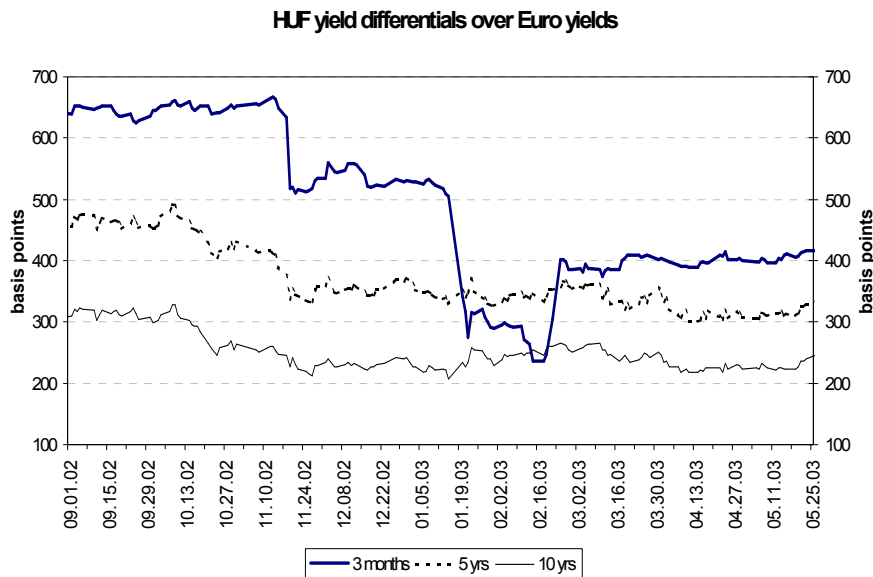


HUF yields have been closely related to euro yields continuously falling since December 2002. The slope of euro yield curve did not change significantly but tilted downwards by some 25 basis points since March. The market also anticipated a cut of 25 basis points in the base rate of euro zone but the European Central Bank did not cut the interest rate since its decision on 6 March. Economic outlook in the euro region did not improve, therefore growth projections had to be adjusted again downwards while ECB has expected falling inflation. These factors were to what long-term yields' reduction by 25 to 30 basis points was due.

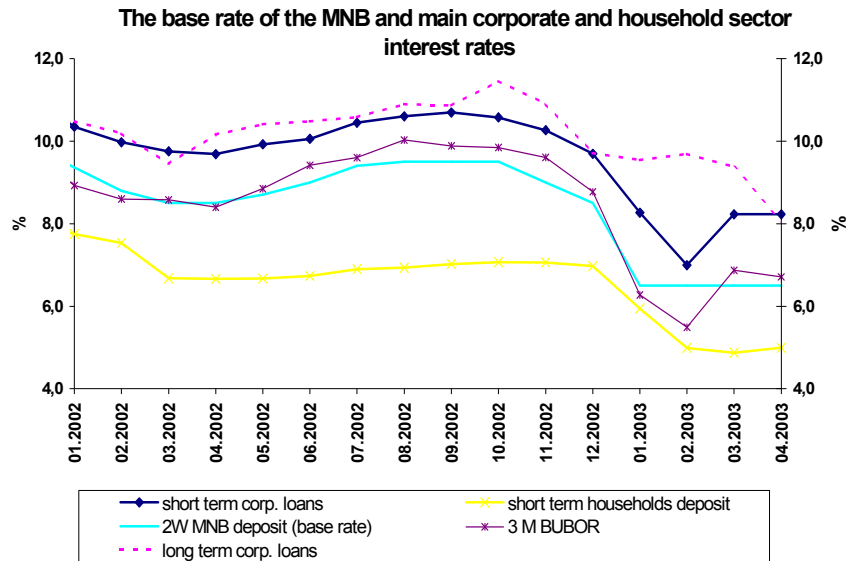


Since after the speculative attack in January, HUF premium above three-month euro yields fell to 400 basis points, it has maintained that level to date. Since both Hungarian and euro yields fell in the recent three months, interest rate margins did not significantly change. In addition, there was no macroeconomic figure justifying any significant change to the premium. In the Central and Eastern European region, Hungary's premia were the highest exceeding by one percentage point the Polish counterpart while the Czech yields essentially stood at the level of euro yields.

Hungarian interest rate premium above euro was stabilized at about 400 basis points

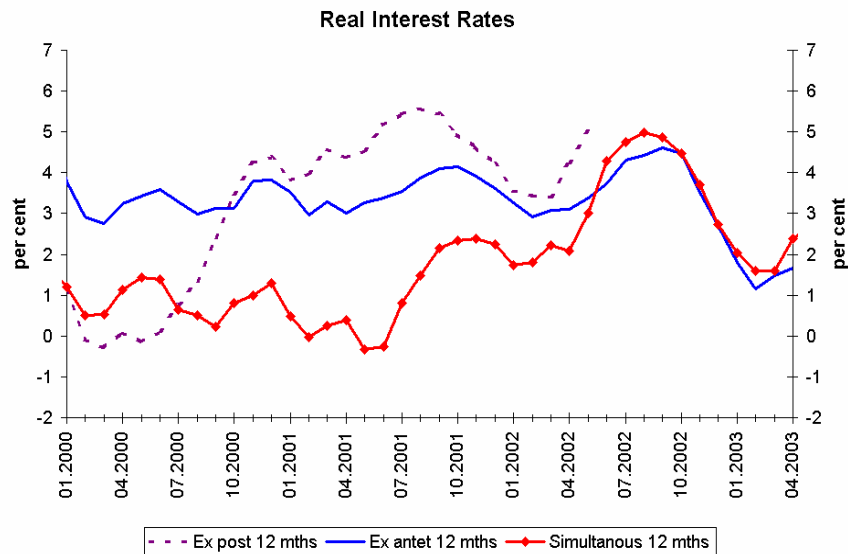


In the recent months, the 3-month money market interest rate has resumed to follow the Central Bank's base rate in line with NBH's primary objectives after having come well below that due to the speculative attack. Short-term business lending rates also run through a path similar to BUBOR, all the more since floating rates are most often pegged to BUBOR. After the speculative attack, deposit rates fell as well but were not adjusted backwards later on.



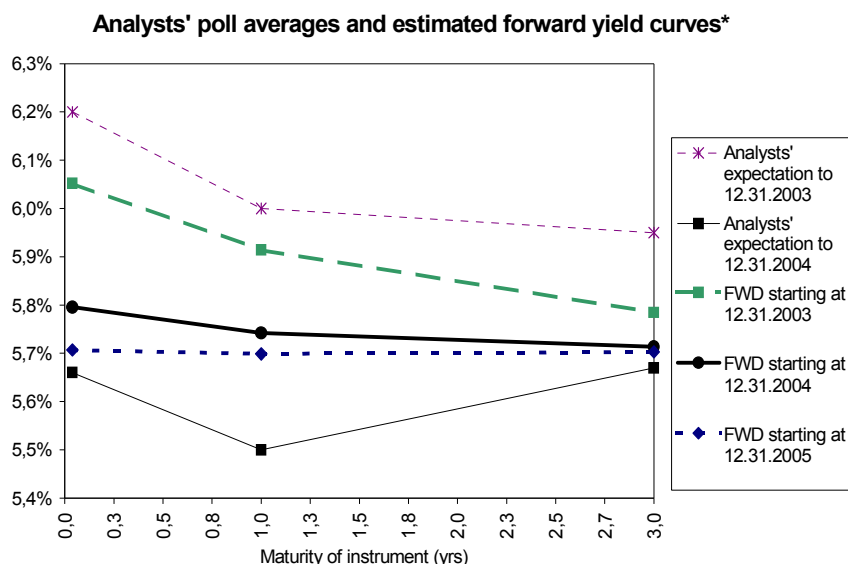
The falling trend of real interest rates since July 2002 was broken in February 2003. As a result of this year lower inflation figures - yields not having changed significantly - the real interest rate started to raise, however, the *ex ante* indicator of real interest rate did not reach 2 per cent even so.

Early in the year, real interest rates began to rise



The ex-post real interest rate ratio: yield of one year discount treasury bill issued 12 months ago, deflated by the current inflation. Ex ante: current one year discount treasury bill yield deflated by the inflation rate expected by analysts to develop in a year's horizon. Simultaneous: current yield to current inflation rate.

Both the analysts' expectations and forward curves² have projected further fall in the yields. According to the expectations by the market or the analysts, the Central Bank's base rate will fall by 25 to 50 basis points and another 50 basis points until December 2003 and the following year-end, respectively. The short end of the yield curve will broadly be horizontal as expected at 2004-end, like in the present situation.

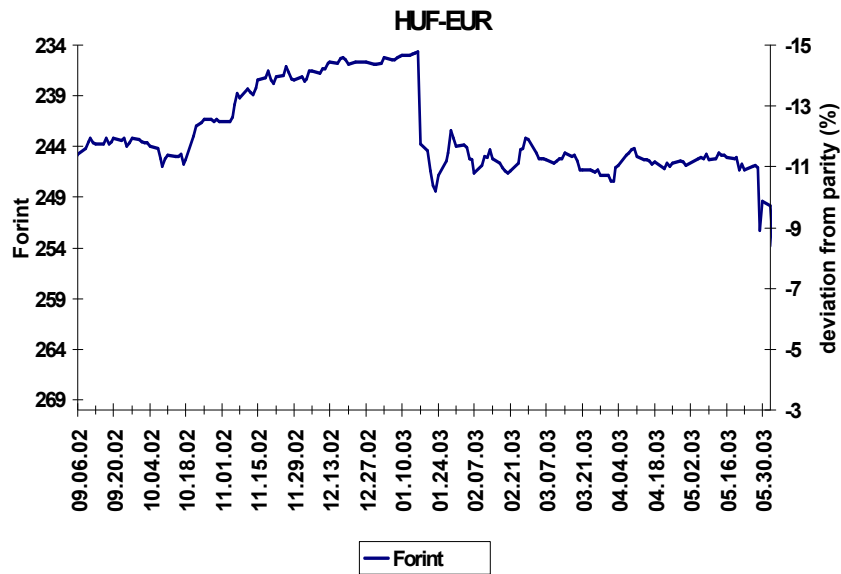


3.3 Exchange rate

After the speculation attack in mid-January had been stopped from the early February until the end of May the HUF exchange rate moved very steadily around HUF/EUR 245 within a narrow range due primarily to the Central Bank's presence in the foreign exchange market, much stronger than before. From the last days of May, the HUF exchange rate weakened some forints as a result of market developments. Central parity of Hungarian Forint was devalued on 4 June by 2.26 per cent. There is an opportunity that following this measure the exchange rate – taking into account the lower inflationary expectations, the import prices in favour, deflationary tendencies in certain countries and wage adjustment processes started in the business sector – providing for the inflation targets to be achieved and at the same time, Hungary's competitive drawbacks accumulated in the recent years to be cut down. As a result of the shift in the fluctuation band, HUF exchange rate should not be stronger than HUF/EUR 240.0 sending a positive message to the exporters and indicating the Government's commitment to competitiveness to be improved.

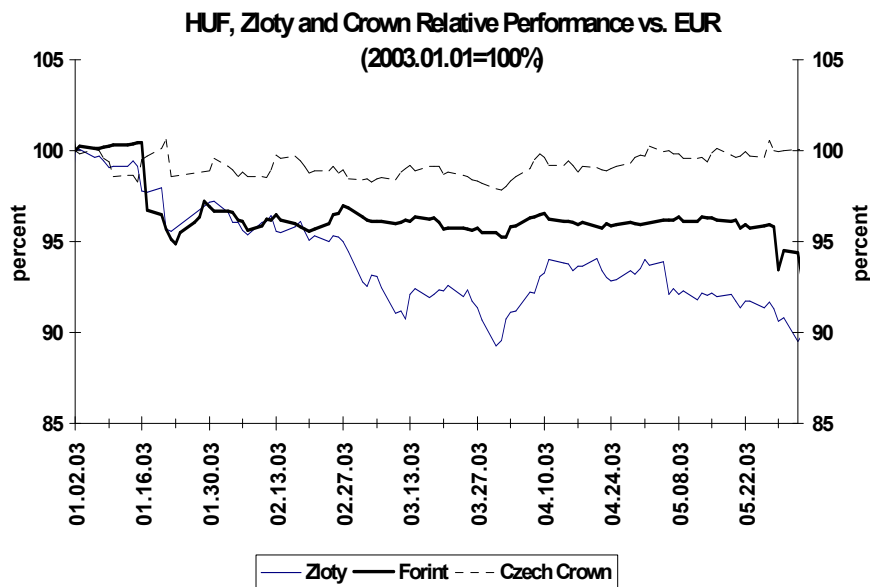
The HUF exchange rate was stable from the early February until the end of May, then weakened. Following the devaluation of the central parity, the inflation targets have been achievable and competitiveness may improve

² For market expectations to be measured, we use two forecast methods. The Reuters prepares monthly surveys for the interest rate level expected by the analysts of the two-week deposits and government securities of 1 and 3 years. In addition, from the basic figures of subscription in the government securities market forward yields are estimated with starting dates and terms equal to the projection of analysts.



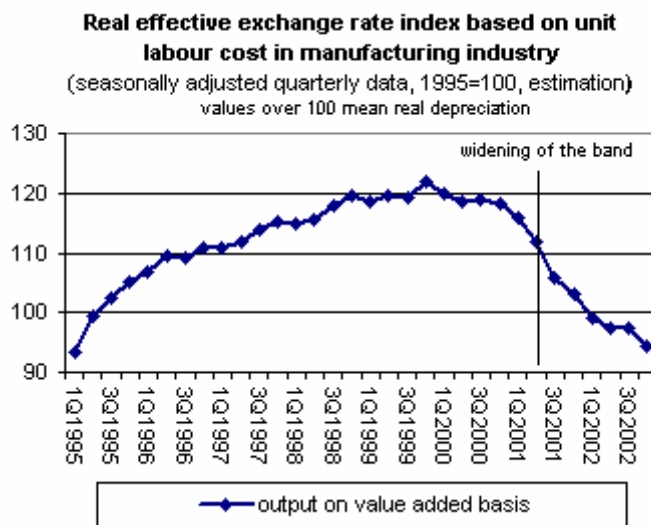
HUF volatility was considered low in the period between early February and end-May, both in historical terms and compared to the fluctuation observed at that time of the major currencies (Polish Zloty, Czech Crown) in the Eastern and Central European region.

Hungarian Forint was stable from early February to end-May in comparison with the Crown and Zloty

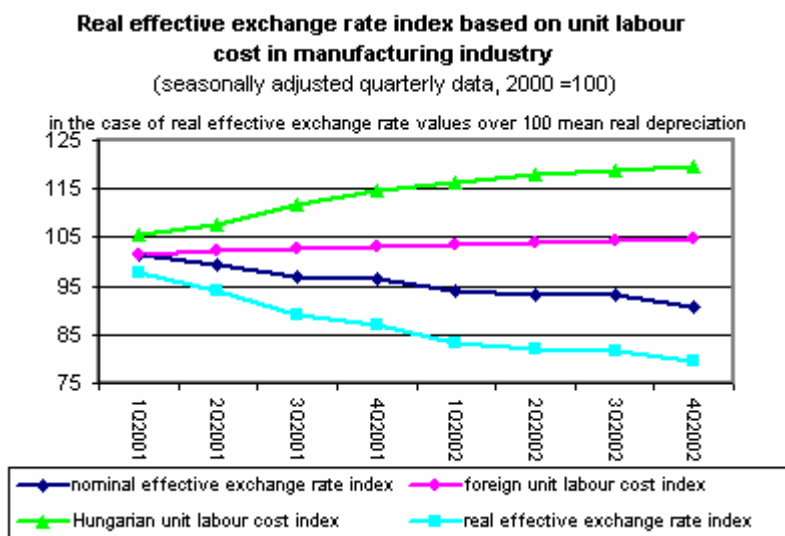


Even before the widening of fluctuation band, there were adverse tendencies concerning competitiveness. The situation so developed was aggravated by the monetary regime change and inconsistencies of economic processes that led too strong a Hungarian Forint. A general and dragging economic downturn sharpened the problems. Deterioration of competitiveness afflicted exports and tourism, reflected in worse current account positions and poor foreign direct investment activity. On the average of recent two years, real appreciation was 16 per cent on consumer price index basis while it made up 18.4 per cent on a manufacturing unit labour cost basis. According to the latter, competitiveness fell by more than 20 per cent in the last quarter of 2002 compared to the last quarter of 2000 and declined to the marking level of the first quarter in 1995.

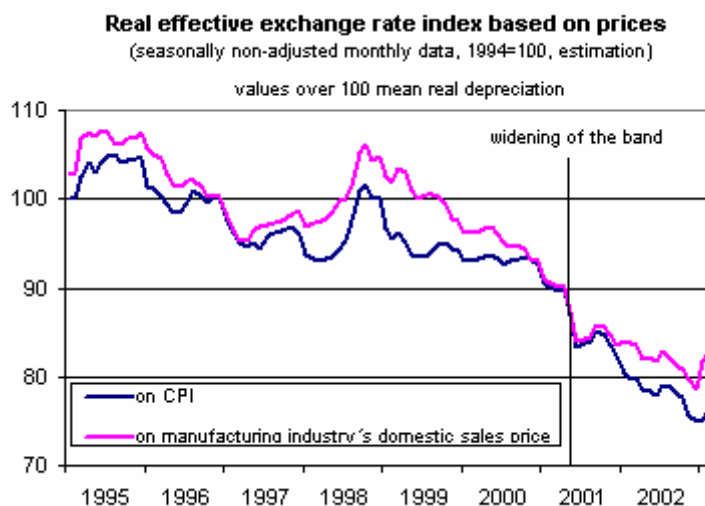
The real effective exchange rate index showed significant deterioration of competitiveness in the recent two years



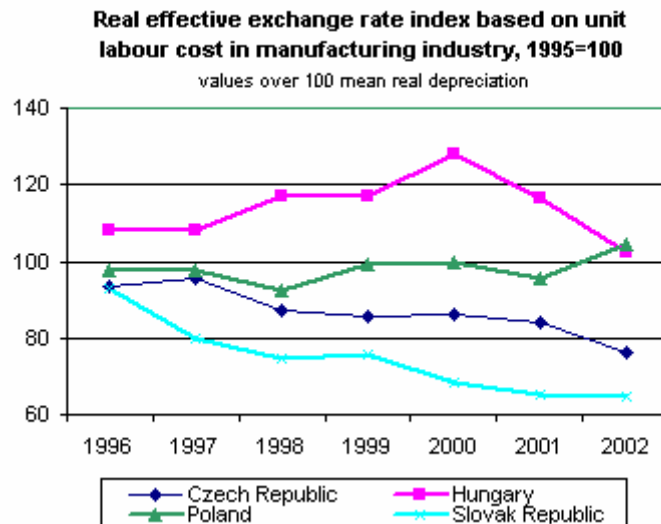
In addition to strengthened exchange rate, the key driver to real appreciation in the recent years was real wage increase significantly higher than the moderate productivity gains.



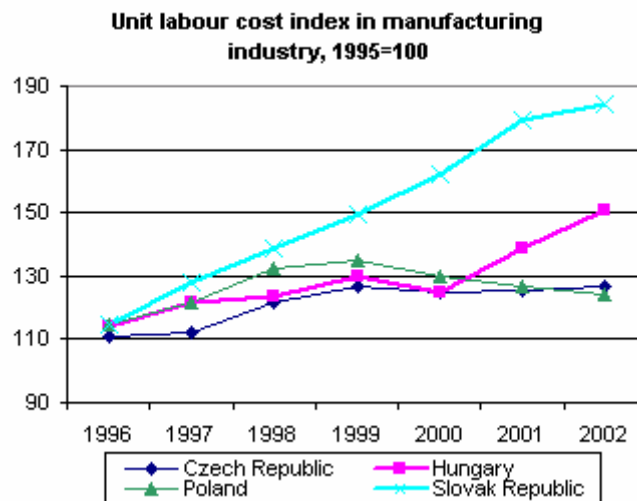
Based on the real effective exchange rate index measured on consumer prices and producer prices, real appreciation further increased, though to a strongly descending pace, if the average of the first two months is compared to the same period of the previous year. However, with reference to the previous year's December, the change will be positive due to the successful disinflation and weakened nominal rate of exchange. (There are no figures for the year available concerning real effective exchange rate index measured on manufacturing unit labour cost.)

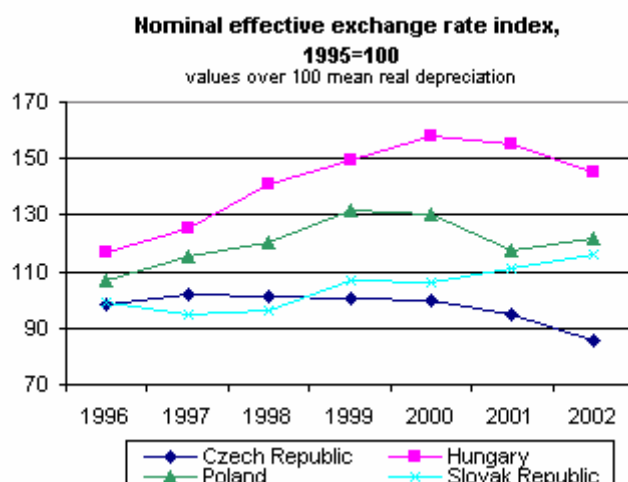


Competitiveness of Hungarian national economy considered a few years ago as favourable even by international standards worsened gradually and our position in relation to our major rivals unfavourably changed. Considering the Czech Republic, Poland, Hungary and Slovakia, it is established that competitiveness according to the real effective exchange rate index based on manufacturing unit labour cost developed as best in Hungary in the whole period between 1996 and 2002. However, it is also true that we suffered the greatest deterioration in this regard during the last two years, well above that in the Czech Republic and especially the Slovak Republic while in Poland competitiveness definitely improved. As a result, Hungary's competitiveness was in 2002 roughly at the level of 1996; Poland had a somewhat better position while in the Czech Republic and especially in Slovak Republic, the deterioration was strong.



The Polish improvement of competitiveness was particularly due to the fact that the manufacturing unit labour cost fell in that period and this was more than offsetting the nominal appreciation (which took place in 2001 in fact while 2002 saw a depreciation). In the deterioration of Czech competitiveness in the recent two years, the nominal appreciation above Hungary's played the determining role while the manufacturing unit labour cost hardly changed. In that period, the Slovak competitiveness also deteriorated but for the reverse reasons to the Czech's, i.e. the nominal depreciation could not offset the increasing unit labour costs, which was similar to Hungary's but smaller than that.





According to IMD's ranking of competitiveness published in May covering several factors, Hungary's position among the countries with population less than 20 million formally worsened 5 places in relation to that reached in the recent two years. In fact, the negative change was smaller because 4 regions were placed ahead of us, which had been never included in the former surveys (Ile-de-France, Bavaria, Rhine-Alpes, Catalonia). Among the countries with population more than 20 million, Poland's place in the rank of competitiveness also worsened. However, disregarding again the countries or regions newly surveyed, its position remained largely the same.

The IMD's survey covering several factors also indicated unfavourable developments of competitiveness

It is obvious that competitive reserves are exhausted by now. In the future, on the average of longer time economic growth is feasible in the event that Hungarian Forint will be appreciated at most by 1 or 2 per cent *per annum* in real terms. In case of benign environment and positive processes, the requirement above could be met both on the unit labour cost-based and price-based real effective exchange rate index, and competitiveness may improve.

On a longer run, real appreciation should not exceed 1 to 2 per cent annually

4. Inflation

Based on CSO figures, good inflation figures were seen in the first three months of 2003 (4.7%; 4.5%; 4.7%) while April brought only 3.9 per cent of price level increase compared to the same month of 2002. This is a serious drop due to permanent disinflation effects, in addition to seasonal reasons.

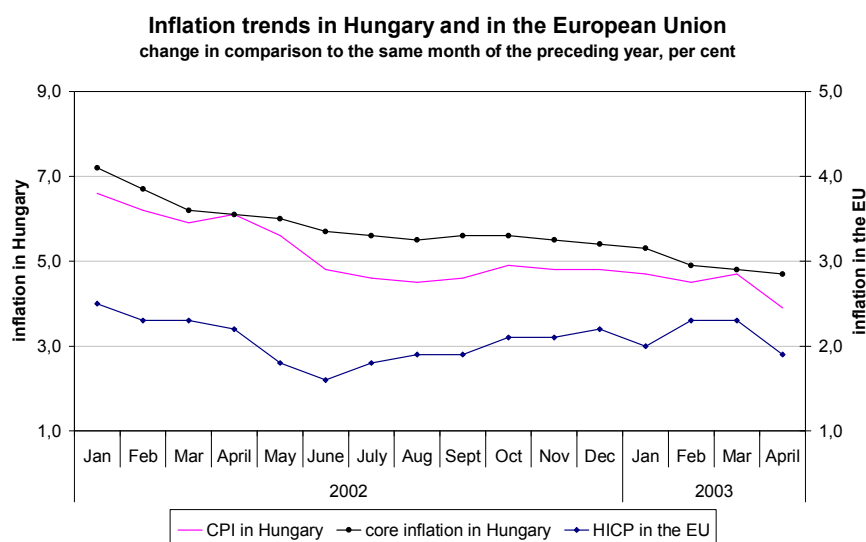
Pace of inflation significantly fell

Based on the international and domestic processes in business cycle and monetary flows as currently seen, taxation changes serving also the purposes of Hungary's EU accession or administrative measures and government programs, it is expected that inflation will further fall but to a slower pace in 2003 than a year earlier to reach an annual average of 4.8 to 5.0 per cent. Moderate inflationary expectations played a greater role in slowing inflation. In addition to a positive external disinflation environment, our inflation targets could be achieved in case of HUF exchange rate weaker than formerly held desirable.

In an environment with so low inflation, re-arrangement of relative prices became apparent. While maintaining our economic and historic characteristics, we gradually approach to the EU relative prices or price level of the Single Market laying stronger foundations for further disinflation and meeting the accession criteria to the euro zone as a key objective.

Annual rate of inflation has a steadily falling trend

Behind the development of inflation including its diminishing trend, there has been a serious re-arrangement of relative prices



Core inflation has been falling like CPI

Disinflation is expected to continue in the following years, however, to a diminishing pace. According to the business cycle and equilibrium situations, inflation could be curbed by 0.5 to 1.0 percentage point annually.

Examining Hungarian households' consumption on the basis of classification of individual consumption by destination (COICOP), it is established that foodstuff, housing expenditure and amounts for transport purposes made the greatest item therein. For this fairly stable segment, the pace of price level increase has slowly been reduced. For other items of consumption (such as market services and industrial goods), more characteristic was the effect by the competitive market to re-arrange the pattern of consumption and to moderate the prices.

Slow change to the pattern of consumption has also influenced the consumer price index

Permanently low agricultural producer prices were reflected in prices as developed in the first four months of foodstuff and non-beverages (most remarkable were the meat products). The annualised pace of price changes for this category of product was 99.8 per cent in April. With agricultural market measures also included, prices in the category may go up by 1 to 3 per cent. Behind the increase of beverages and tobacco products, there played a role the change excise taxes, in addition to the increase of producer costs. In the category, prices rose 4.8 per cent until April and 10.5 per cent over twelve months.

Price increase of foodstuff was moderate while excise tax rose on tobacco products

Clothing and footwear are typically seasonal type of products. Springtime choice appeared in March to April offsetting the drop in price level measured in January to February. Therefore, the 12-month rates moved around 3 per cent. For the whole year, similar rates are expected.

Clothing and footwear prices showed seasonal effects

Most marking disinflation was still seen for industrial goods. For durables or motor vehicles, statistics registered falling prices in nominal terms.

Inflation for industrial goods was low

Group of housing services produced a price increase above the average inflation, in particular, as a result of price increase of services (the weight of industrial goods within that group is not very significant). In the market, both repair and maintenance services and community services (particularly such as waste and sewage disposal) were present. For the whole year, price increase above the average is likely as well the rate of which, has, however, been conditional on the counting of the compensation of gas price increase. In the category of *furniture and household equipment*, an average price increase of services and a below-the-average price increase of durable consumer goods and consumable supplies, as well as that of general industrial goods together formed the price increase above the average. The annual average here is expected around 1 to 3 per cent.

Housing-related services saw higher prices while product prices increased more slowly

Market services were becoming expensive above the average. This is especially observed where the service in question has no substitute, rival from its very nature or the increased purchase power will allow for major price increase to be effected.

Market services' price increase was above the average. That difference seemed to be stable

In the *healthcare*, the weight of medicines was determining. The latter's price increase was 4.7 per cent and 9.0 per cent measured on 2002 December and over 12 months, respectively. For the category as a whole, the same rate applies including the whole year.

Medicines' price increase was above the average

In the group of *transport and traffic*, characteristic were low, sometimes declining price increase of motor vehicles and parts, fast price increase of services related to operations and maintenance, moderate price changes to local and inter-city transport as well as volatile movement of fuel prices. It was reflected in the fact that fuel price level rose 8.3 per cent from 2002 December to March of 2003, and then fell 6 per cent in one month of April.

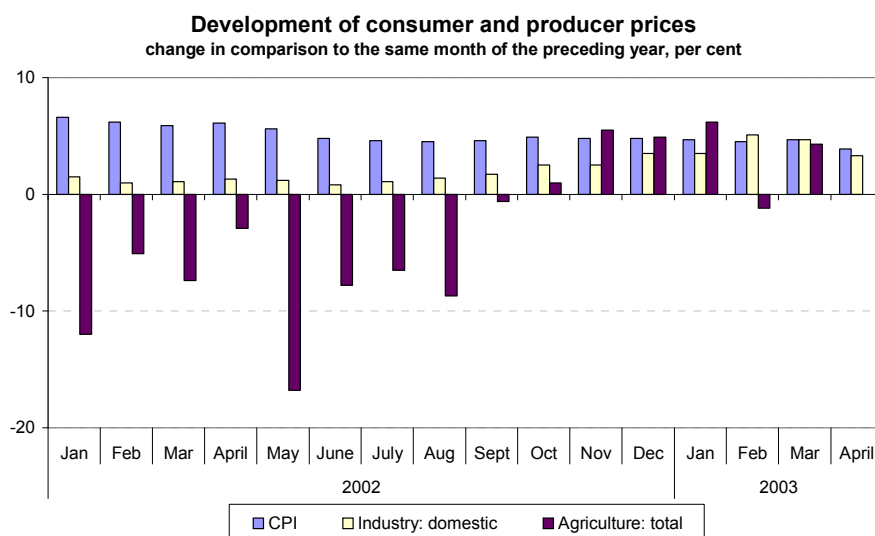
Cars were cheaper but repair services more expensive and fuel prices very volatile

For *telecommunications*, phone-related services' moderate or below-the-average price increase was determining. This trend will probably prevail for the whole year. In the field of leisure and culture, falling prices of purchasable equipment and devices, higher prices of repair-related services, and significantly increasing prices of books, newspapers and magazines were marking so far. Overall, an about-the-average price increase is expected for the whole year. The above-the-average price increase - over 10 per cent - of *education* is considered to be permanent. The pace of price increase for *the group of restaurants and hotels* fell (the 12-month increase of 10.7 per cent in December went down to 8.2 per cent in April.) For the future development, wage costs and purchase power were jointly accounted, like with the most market services. Among *other products and services*, outstanding price increase of hairdressing and body-care services should be mentioned.

Prices of books, newspapers rose significantly while market services became more expensive above the average

Naturally, the change to consumer price level should not be understood *per se*. The comparison with the price change to productive sector is to be served by the following chart.

Fluctuating prices of agricultural producers were characteristic



On the average of the first three months of 2003, *agricultural producer prices* exceeded by only 0.3 per cent the same period's a year earlier. For farming crops, the price increase was 4.4 per cent on the average (excluding vegetables and fruits, 1.9 per cent). For animals and animal products, the average price level of the first quarter was 5.1 per cent left below the same period's in 2002. In this context, the positive index of beef calf, cattle and milk made difference from the general decline. In Hungary, agricultural prices are rather volatile. However, as a result of certain agromarket intervention moves (especially for the pig market), moderate price increase is expected for the rest of the year.

Agricultural producer prices remained on the last year's level

Fall of *domestic industrial producer prices* in 2002 underpinned disinflation significantly. In the first quarter of 2003, prices showed a rising tendency, particularly in energy-producing branches. For those producing for further use or those making durables, compared to the proper indices of consumer prices, it was seen that the increased purchase power did not involve real drive for inflation. In April, particularly in the wake of international oil price developments, prices went down. The slower pace (from 2002) measured in the branches making investment goods is mostly explained by the business cycle. For this year in total, 2 to 4 per cent of price increase on the average seems likely as conditional upon the international price tendencies and domestic economic upturn. After the fall in 2002, *export selling prices* in HUF rose and is expected to rise in 2003.

Domestic producer prices rose at a pace exceeding the last year's, following particularly energy prices

In *building industry*, the cost-based producer price index was 105.3 and 105.2 per cent in March and on the average of the first three months, respectively, somewhat higher than had been the average in 2002. Like for investment goods, building upturn was not strong as showed in the short-term price developments.

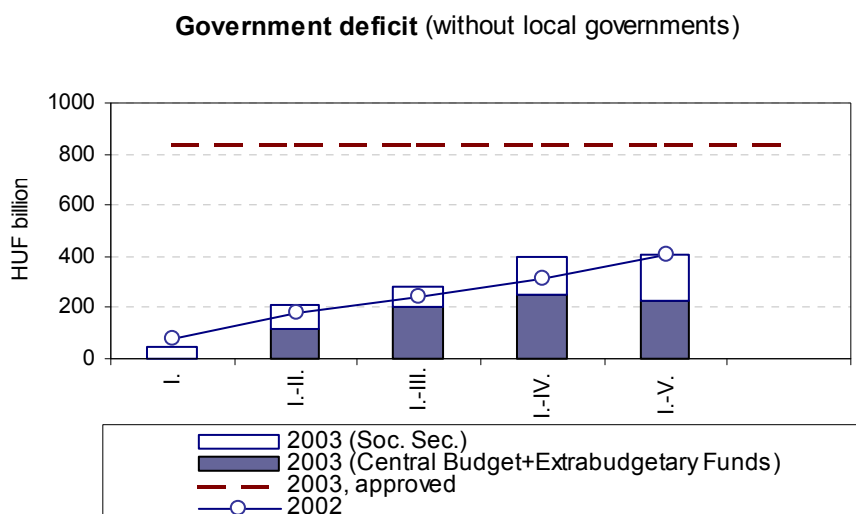
Business cycle changes in building industry were reflected in the prices

5. Income and financial flows. Equilibrium.

5.1 Equilibrium factors

We have only partial figures concerning the national economy's equilibrium factors. The deterioration of current account development indicates in any case that external financing requirements increased. General government borrowing requirement will, however, be less than last year. The figures existing refer to a possible growth of enterprises' net borrowing while those were in a position of net savings last year. For the time being, there is no information of the households' savings. Significant growth in this context is not expected in 2003. Thus, the overall external financing requirement will rise to all probabilities.

There are only partial figures available for equilibrium factors



5.2 Central government

Based on preliminary data, the growth of the government deficit³ largely slowed down in May. The balance in May (excluding local governments) closed at a deficit of HUF 8 billion. Thus the total deficit for the first five months of the year achieved HUF 409 billion or 49 per cent of the annual appropriation. (The central budget, the social security funds made a deficit of HUF 253 billion (44.4 per cent) and HUF 181 billion, respectively. Extrabudgetary funds showed a surplus of HUF 25 billion.) In May 2002, the deficit of HUF 409 billion (also) made 81 per cent of annual projection and 26 per cent of annual fact-figure (excluding the year-end debt assumption and debt cancelling operations: 39.5 per cent).

Deficit growth slowed down in May

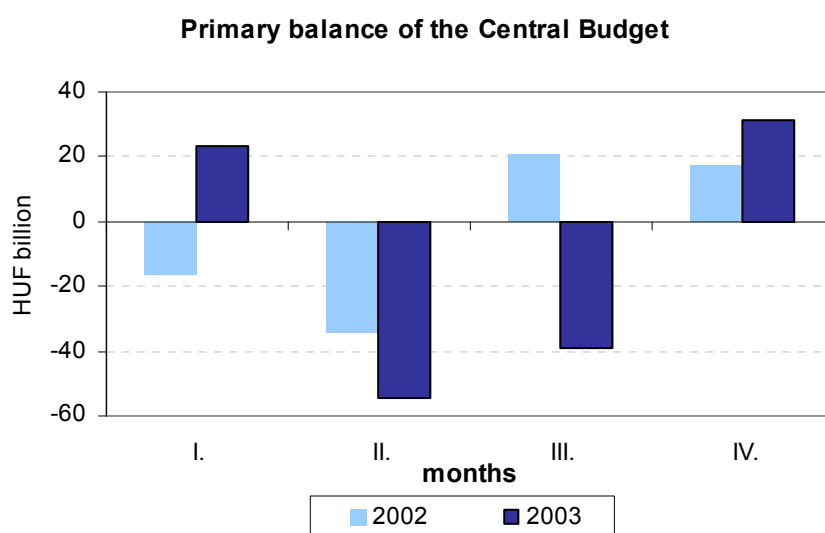
We have detailed figures only about the first four months. In April, general government deficit was HUF 118 billion (excluding local governments), thereby the deficit rose to HUF 400 billion from the beginning of the year or almost a half the annual appropriation of HUF 832 billion (48 per cent). Central budget deficit was HUF 276 billion; social security funds' deficit made up HUF 148 billion (53.3 per cent) while extrabudgetary funds achieved a surplus of HUF 23 billion. In 2002 to April-end, the deficit was HUF 84 billion less. That time HUF 316 billion made 62.5 per cent and 20 per cent of the annual appropriation and the annual fact figure, respectively (excluding the year-end debt assumption and forgiveness operations: nearly 31.0 per cent).

Contribution to the relatively high deficit in April ...

³ Facts and figures used for the analysis present the situation of government excluding local government and on cash basis.

To assess the relatively high deficit in the first four months of 2003, the following should be kept in mind. According to the usual seasonality, both social security and the central budget usually pay out more than would be needed in a timely pro-rata manner due to transfers to local governments, which are higher early in the year; financial management advances to be refunded later on and salary advances for the 13th month at the health services. In April there was another special and individual factor. In particular, both central government agencies and social security administrations (for health services) had transferred at the end of April the wages payable early in May because of 4-day holiday. This individual circumstance deteriorated the balance by some HUF 25 billion in relation to the usual rate while contributing to the better figures in May. The monthly average deficit of HUF 63 billion (on two months) was somewhat lower than the pro-rata share for one month of the annual appropriation (HUF 69 billion).

... one-off effects were also involved



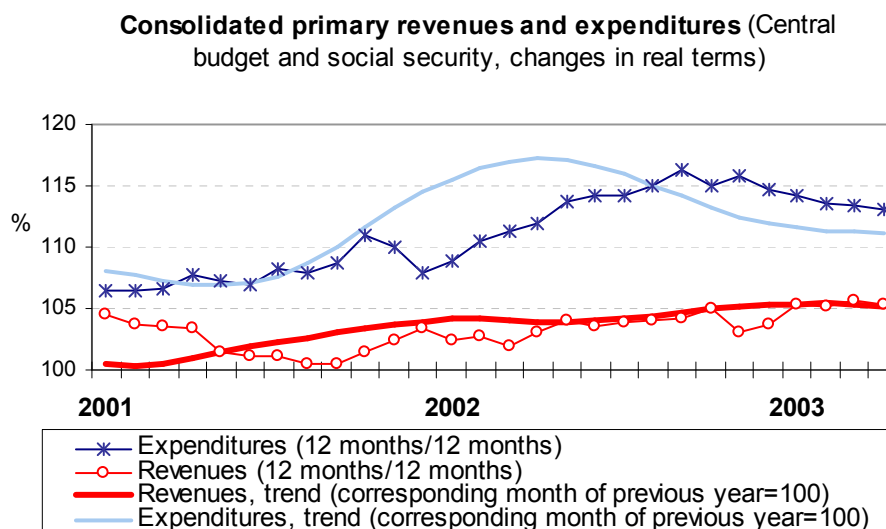
In April, the deficit further increased by, beyond the foregoing, interest paid of HUF 88 billion exceeding the figure that had been usual in the former months. Primary balance of central government budget showed a surplus of HUF 31 billion.

The government (excluding local governments) had the revenues in the first four months of the year somewhat left behind the timely pro-rata figure but even so, the performance rate (32.2 per cent) was nearly 2 percentage points above the last year's. Consolidated primary revenues of the two major government levels, the central budget and social security funds (excluding internal transfers as well as own revenues of government agencies due to a significant double counting) increased by more than 8 per cent including receipts from taxes, tax-related services and contributions, which totally rose 7.5 per cent in real terms.⁴

Until April, revenues rose less dynamically ...

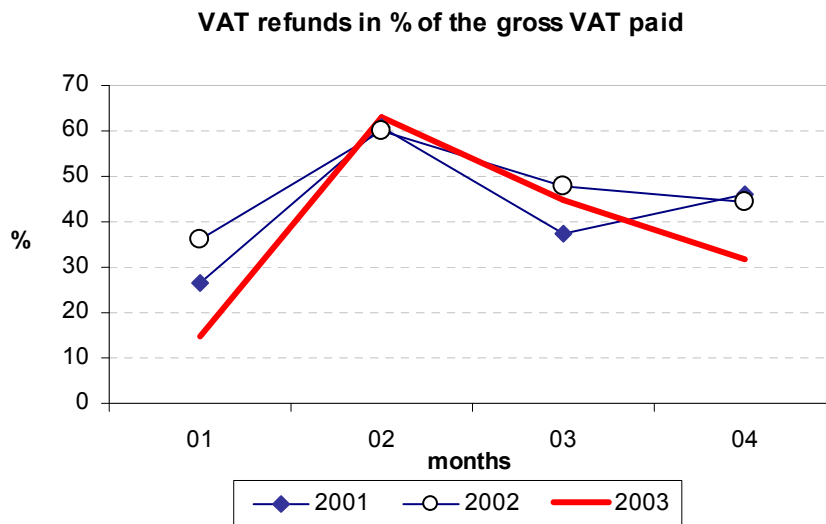
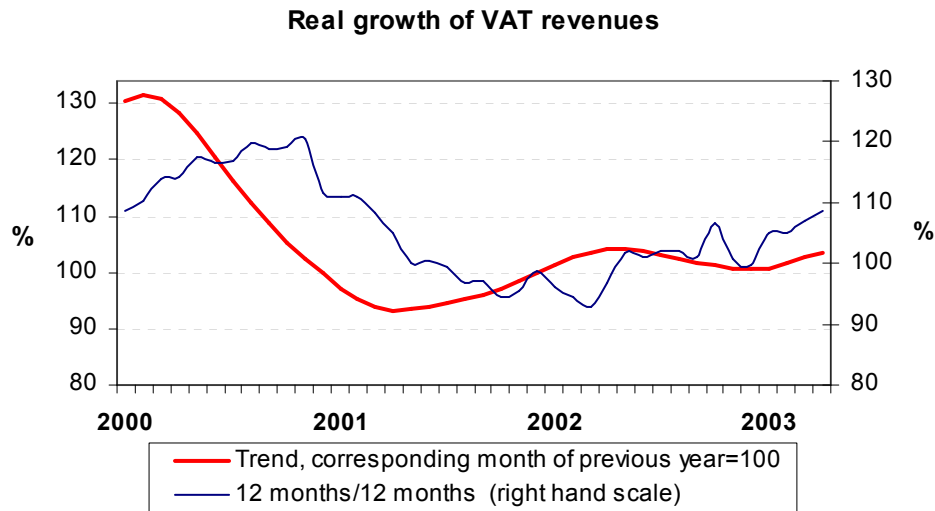
Until April-end, expenditures were fulfilled at a higher rate (33.8 per cent) than revenues, and even surpassed the pro-rata figure (33.3 per cent) of the first four months. (By May-end, performance rate of expenditures as 0.5 percentage point lower than the pro-rata figure of 41.7 per cent while the gap between the performance rates of revenues and expenditures fell to a half, from 1.6 percentage points to 0.8 percentage point.) Consolidated primary expenditures of the central budget and social security funds in January-April rose more than 12 per cent in real terms from the same period of last year. The so-called "rolled indices" (12 months/12 months) and the indicator of trend variation show the changes. These presented that the growth of expenditures slowed down but those were still more dynamic than the increase of revenues. In the rest of the year, however, compared to the higher and higher basis of reference period, the growth rate of expenditures will certainly slow down. (Disregarding debt assumptions and cancelling at 2002-end for comparison purposes.)

... than expenditures



⁴

For the calculation of real growth, the consumer price index was used as deflator, even if the logic of economics would have justified another indicator (e.g. GDP deflator) since only for the consumer price index there are interim (monthly) figures available.



In detail, the performance rate (35.1 per cent) of VAT revenues having the greatest weight among central budget receipts exceeded by nearly 2 percentage points the timely pro-rata figure and more than 1 percentage point the last year's performance rate. VAT revenues rose more than 26 per cent (nearly 21 per cent in real terms) from January to April compared to the same period of 2002. "Rolled" indices of changes from the previous 12 months indicate acceleration of revenues, also confirmed by the indicator of trend variation.

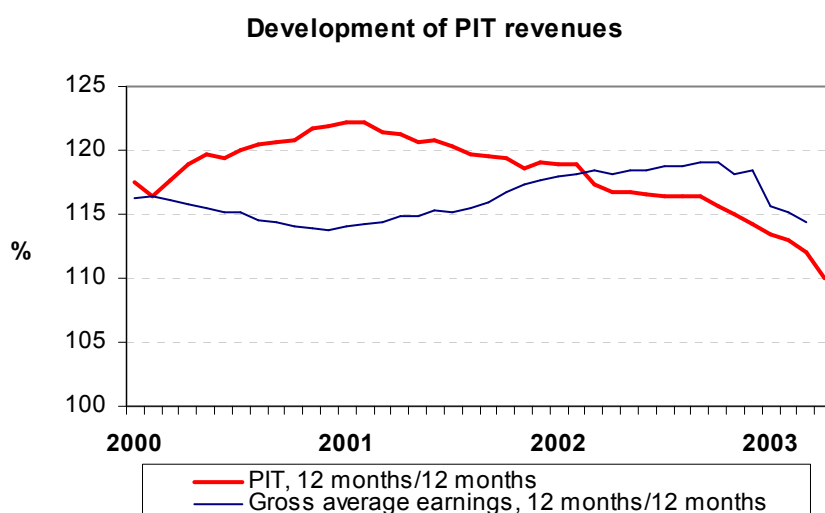
Receipts from consumption-related taxes are favourable ...

It should be taken into account at the same time that VAT refunds showed a fluctuation stronger than last two years, significantly influencing the amount of net receipts appearing in the central budget.

Revenues in four months from excises increased by almost 10 per cent from the last year's while its performance rate was a little better than in 2002.

The personal income tax having the second largest weight produced a performance rate at general government level that sensibly slowed down by April while exceeded both the pro-rata and last year's figures in the first two months (January: 11.6 per cent; January to February: 19.6 per cent up against the last year's 11.1 and 19 per cent, respectively) and only a little trailed behind the last year's figure in March (first quarter: 26.2 per cent up against 26.4 per cent in 2002). The performance in four months was lower than both the pro-rata figure and the last year's value (31.6 per cent against 33.1 per cent in 2002 January to April). Revenues increased much more slowly (3 per cent in January to April from the same period last year) than gross earnings of national economy as a result of changing tax rules, smaller tax burden as well as higher tax refunds in relation to 2002 tax accounts. The difference between growth rates was presented in the "rolled indices" showing the change from the previous 12 months.

... however, receipts from personal income tax have increased more slowly than earnings



Unlike personal income tax, the increase of receipts from social security contributions was in accordance with the increase of earnings. Receipts from contributions in January to April surpassed by 13.6 per cent the last year's figure.

The amount of receipts from contributions was satisfactory

Among expenditures, housing subsidies, transfer to local governments as well as debt service related expenditures exceeded the pro-rata measure in the central budget until April-end. Among social security expenditures, in the health insurance benefits in cash and in kind, there were disbursements exceeding the pro-rata figure for four months such as sickness benefit, maternity benefit, health services, pharmaceutical subsidies, etc.

Certain items of expenditure exceeded the pro-rata figure of the related appropriation

The government budget for 2003 earmarked **public debt** growing more slowly and bringing down deficit in light of which the Government determined net financing needs as HUF 832 billion or lower than had been in 2002. The gross financing requirement will grow as a result of the jumping repayments in the year as well.

In 2003, the government deficit and net financing needs will be cut

DEVELOPMENT OF GROSS BORROWING POSITION (HUF million)

	1998*	1999	2000	2001	2002	2003**
Deficit of the central government budget (excl. privatisation revenues)	-370,2	-338,1	-330	-413,2	-962,65*	-569
Social Security Funds financing requirement	-88,9	-46,6	-70	-32,3	-101,3	-277,1
Extrabudgetary Funds financing requirement	-12,5	-40,4	0	-2,3	1,5	13,9
Net borrowing position	-471,5	-425,1	-400	-447,8	-1062,5	-832,2
Funds covering exchange rate losses of the NBH					-250,2	-82,9
Privatisation revenues and the balance of capital market operations	-13,1	8	0,9	0	0	100
Total redemptions	-1843,3	-2659,8	-3088,7	-2993,9	-3951,3	-4975
Gross borrowing position	-2327,9	-3076,9	-3487,8	-3441,7	-5264	-5725,2

* excl. 512 billion HUF for loans assumed in December 2002

** According to the Act on annual budget, 2003

In 2003, three principles are to guide the debt management strategy:

- Government budget deficit is financed from the domestic money and capital market.
- Matured HUF debt is domestically renewed in Hungarian Forint while foreign exchange funds provide for FX debt to be renewed.
- Stability and level maintained of Single Treasury Account (KESZ) guarantees the secure financing.

Conditions for financing government debt improved in January to April 2003. Due to the buoyant demand in the government securities market, conditions turned for the better. Among the factors affecting public debt, the central government, the social security funds and extra budgetary funds made a cumulative deficit of HUF 408.7 billion. The net monthly financing requirement as consolidated moved in the range between HUF 40 billion and 160 billion. The replenishment of the National Bank of Hungary's settlement reserves made up more than a half of full financing requirement in March.

General government financing in the 4th quarter of 2002 (billion HUF)						
	2003. January	2003. February	2003. March	2003. April	2003. May	2003. I-V. months in total**
Deficit (central government budget, social security funds)	53,9	173,7	74,4	119,6	12,2*	433,8
Repayment (HUF and FX)	323,53	422,62	460,9	423,6	372,04	2002,69
Financing requirement	377,43	596,32	535,3	543,2	372,04	2436,49
Gross issue (HUF)	560,21	520,66	477,42	515,56	466,21	2540,06
Other	0	124,8	51,67	0	3,8	180,27
Total	560,21	645,46	529,09	515,56	470,01	2720,33
Over/underfinancing	182,78	49,14	-6,21	-27,64	97,97	296,04

* Preliminary data published on 2 June 2003

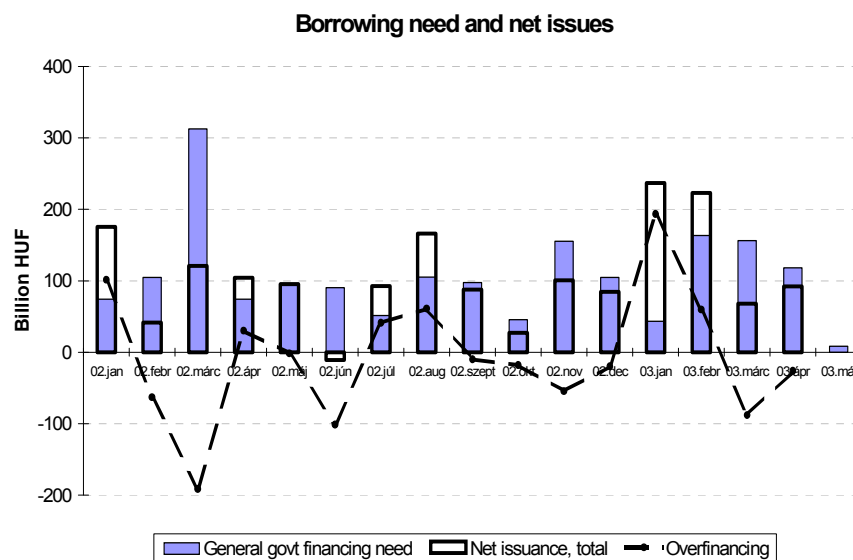
** According to the data for the first five months in case of the deficit and to the data for the first four months and the preliminary data for May in other cases

Repayments went on as planned. However, HUF issue was higher than projected as a result of significant demand and good conditions. In the auctions of government papers, the overall amount of issue was HUF 190.5 billion more than announced. From the amounts announced, government bonds and discount T-bills made issuances in fact at HUF 169 billion and HUF 21.5 billion more, respectively. This is the strategy allowing for partly early repayment of loans assumed at 2002-end and interest payable to be cut down.

Government paper auctions were successful due to a strong interest

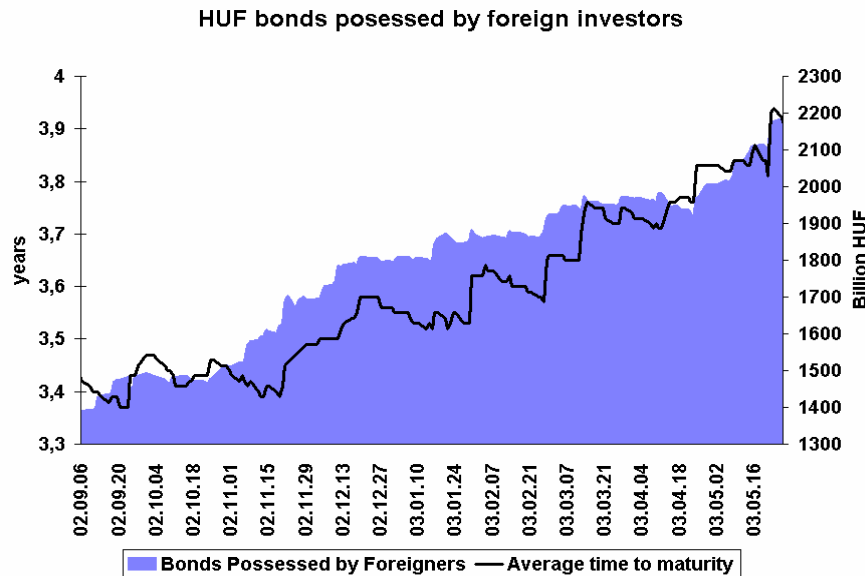
On an annual basis, proper coverage was in place both in the markets of government bonds and discount T-bills. Most secondary market transactions continued to be realised in OTC markets.

Overall, it is established that general government financing was balanced in the first five months of 2003 except for January when significant overfinancing was made.



Foreign participation was dominant in the demand for government papers. Foreign-owned government securities went up to HUF 2109 billion by the end of May. The speculation attack in January was hardly felt in the market of government securities. The increase of non-residents' government securities went on in the midst of a six-month prolongation of the average time to maturity.

Foreigners were dominant in the market of government securities



Central government debt in gross rose 8.5 per cent to HUF 10007.33 billion by the end of April from December 2002. Share of foreign exchange debt fell by 0.4 percentage point, making 24.2 per cent within total debt in the same period.

5.3 Households' financial savings

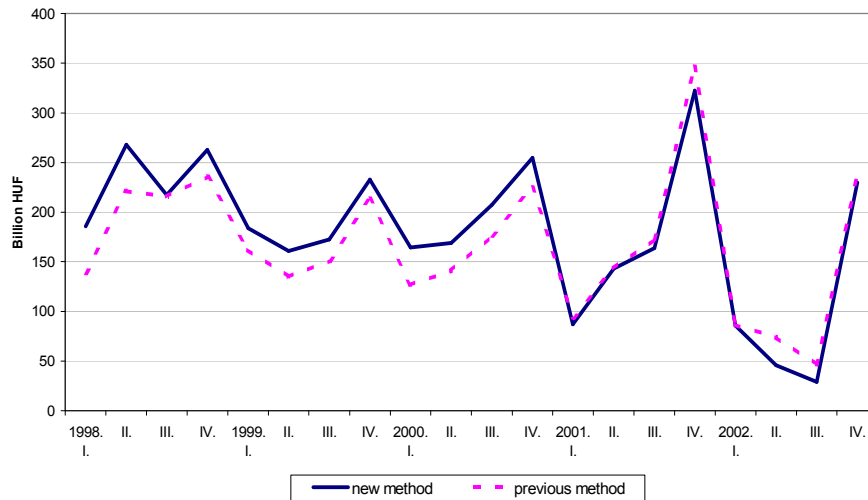
Based on a new methodology, the National Bank of Hungary released its quarterly data on the households' financial position as a part of system of financial accounts. Since public information of first quarter of 2003 are not yet issued. Our analysis should be limited to outlining the processes in the year and those expected for the next year.

System of financial accounts as compiled by the NBH had a more than ever comprehensive picture of financial assets and liabilities of national economy sectors or the changes to financing relations of market players. Methodology shift hits on several points the way of accounting for the households' financial worth. Apart from a few statistical changes, the most important shift was to enlarge the range of assets and liabilities covered. This enlargement hardly affected the tendency seen for the sector's net position. Changes were crucially felt in increasing the stocks (stock of financial assets rose HUF 3605 billion while that of financial liabilities did HUF 344 billion according to 2002 December data.

Calculation of the households' financial position has been prepared on a new methodology basis

Stocks changed significantly while net financing capacity was hardly modified as a result of improvements

Development of net financial capacity of households
1998-2002

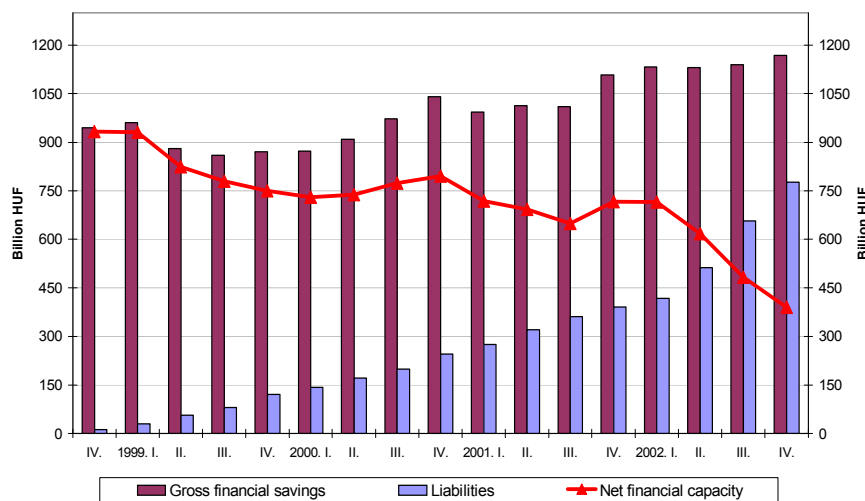


Applying the new methodology hardly changes the rate net financing capacity of in the households' sector relevant to national economy balance. In the new figures, the gradual decline of the sector's net financing capacity is also felt. The cumulative figure of HUF 390.7 billion calculated with the transactions involved was lower than the figures in the previous two years.

That significant decline of the households' net financing capacity experienced in the recent years is explained by the households' economic or financial outlook, or a dynamic run-up of home-lending activity subsidized by the Government.

Our judgment remained the same about the processes of recent years

Development of the financial position of households
(1998-2002, new methodology, 12 months accumulated values)



In the households' savings in 2003 as expected, the following motives play key part. The households' confidence index published by the GKI Rt. (Economic Research Institute, inc.) has been deteriorating from time to time; more cautious approach to consumption is possible. Government subsidies to home loans were restricted. All this may have a positive influence on the households' financing capacity; they could increase their savings. With a view to the effect of the two factors mentioned above, the drastic decline experienced in the recent years is believed to be moderated in the field of the households' net savings. In 2003, such a net position is expected as lower than last year, or in the best case, it would be equal to the last year's net position.

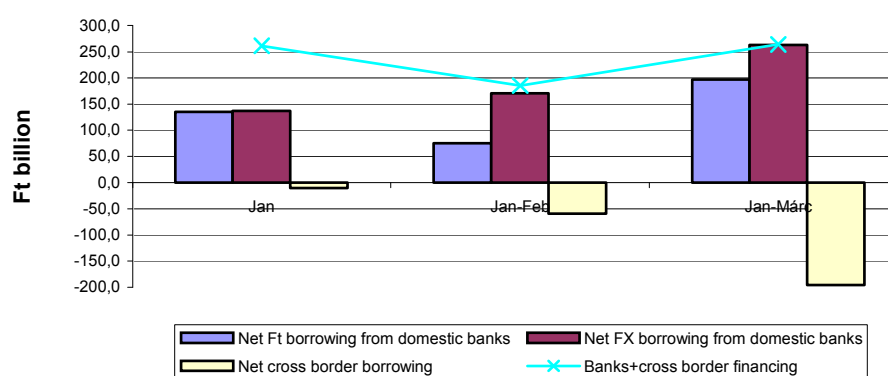
Significant decline experienced in recent years in the net savings position may be reduced

5.4 Corporate sector

Based on the data of national economy financial accounts, the corporate sector became net creditor in the last three quarters of 2002. The net funding from external sources – by HUF 10 billion – still existing in the first quarter changed for a net outlay of HUF 267 billion by the fourth quarter. In the first quarter of 2003, despite a continued adverse business cycle, corporate funding from external sources seemed to grow. Against the increase of net debt to domestic banks by HUF 460 billion, there was a net foreign position improved by HUF 196 billion, as well as a total expansion of government papers and investment notes by HUF 116 billion in total. As a result of the processes above, corporate financing needs rose HUF 148 billion through the channels mentioned that could indicate increased business or activity.

Corporate funding from external sources has begun to grow through the major channels

Corporate sectors financing from the domestic banks and abroad
2003.**



* without credit institutions

In the change to position against domestic banks, the net FX funding of HUF 247 billion had the key role with a figure almost 2.5 times as large amount as had been a year earlier. Especially great FX credits were made by the banks to non-financial enterprises in which the break of appreciation trend and the banks' FX liquidity probably played important part. Change to net HUF position was due practically to a significant decline of corporate HUF deposits almost to the full. The latter made up more than 2.5 times as large amount as had been that in the first quarter of 2002.

Change to cross-border claims was as a result of portfolio investments and the decline in debt-generating funding from external sources in total. Decline of funding from external sources in the first quarter of 2003 makes approximately a half of the 2002 first quarter's and was due to repayment of intercompany loans to a half.

5.5 Current account deficit and its financing

The tendency of deterioration in the **current account positions** as observed since the third quarter of 2001 continued in the first quarter of 2003 as well. In addition to services, increasing deficit of trade in goods and raising interest charges, due to the raising foreign debt, caused the rise in current account deficit. As a result, the deficit achieved the amount of EUR 987 million, exceeding by EUR 500 million the rate of the reference period.

In the first quarter current account deficit has continued to grow

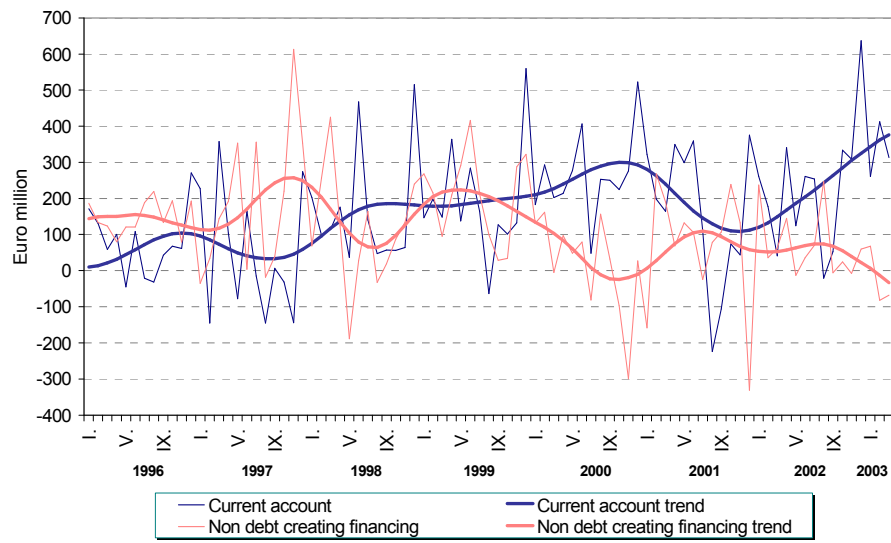
Deficit of trade in goods was EUR 302 million higher than the previous year's, mainly in line with high import payments in March. Balance of services was EUR 160 million worse than had been in the first quarter of 2002. In this context, revenue surplus of tourism further shrank (EUR 62 million) since the cut in revenues was larger than the cut in expenditures. Balance of earnings worsened only by EUR 37 million in total in the context of which the deterioration of interest balance made up EUR 63 million. The active balance of earned incomes was also reduced a little. However, the mitigated profit expatriation – by EUR 40 million – improved the situation.

Balance of tourism has further worsened

From the debt there will be 2003 figures available at the end of first six months. Some rise is obvious based on the foregoing. Reserves made up EUR 12.5 billion at the first quarter-end.

Financing structure changed for the worse in that today the net outflow of non-debt-generating funds has no longer gone with a dynamically increasing current account deficit. Last year, the net foreign direct investment was EUR 335 million in the first quarter while in 2003 the outflow made up EUR 82 million. Against this background, there was the fact that foreign direct investments were left well below the last year's, making up just EUR 80 million. On the other hand, the Hungarian enterprises' foreign investments achieved EUR 366 million, particularly as a result of MOL privatisation payments in relation to EUR 38 million in the reference period. The position of portfolio investments (EUR 206 million) was better than had been a year earlier (EUR 113 million), however, they could not offset the negative tendencies mentioned above. All this resulted in increasing net debt. In the first quarter of 2002, non-debt-generating capital inflow financed in 70 per cent the current account deficit, thus debt-related financing needs made up only EUR 145 million while this year, it was some EUR 1 billion. Foreign capital inflowing into the government securities market played a key role in financing the national economy. In the first quarter of 2003, foreign-owned government securities of HUF denomination went up by HUF 200 billion. As a consequence, foreign debt by the government increased and the government's share increased within net debt.

The current account deficit and the non debt creating financing, net



Budapest, 5 June 2003